SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 341

D. B. HEINER, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

vs.

JAMES R. TINDLE AND THE UNION TRUST COMPANY OF PITTSBURGH, CO-EXECUTORS, ETC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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1 In United States District Court for the Western District of Pennsylvania

JAMES R. TINDLE AND THE UNION TRUST COMPANY OF Pittsburgh, co-executors of the last will and testament of Philander C. Knox, deceased, plaintiffs
v.
D. B. HEINER, COLLECTOR OF UNITED STATES INTERNAL Revenue for the 23rd District of Pennsylvania, defendant
} Law No. 3432

Docket entries

Jan. 22, 1926. Praecipe for summons in assumpsit and statement of claim filed.

Jan. 22, 1926. Summons in assumpsit issued returnable 1st Mon. of Feb. next.

Jan. 29, 1926. Summons returned served on D. B. Heiner, collector of internal revenue, 23rd Dist. Pa., by handing to and leaving
2 a true and attested copy thereof with D. B. Heiner, personally at Pittsburgh, Jan. 23, 1926.

Feb. 2, 1926. Praecipe for appearance of John D. Meyer and W. J. Aiken for deft.

Feb. 25, 1926. Affidavit of defense filed.

Mar. 10, 1926. Stipulation waiving jury trial filed.

Mar. 10, 1926. Trial without a jury had; C. A. V.

Mar. 10, 1926. Witnesses sworn for plff. (4).

Mar. 10, 1926. Motion of W. J. Aiken, for the court to render judgment for the defendant filed.

Mar. 10, 1926. Trial mem. filed.

Nov. 23, 1926. Opinion entitling plaintiff to judgment in sum of $4,863.04 with interest from February 2, 1925, and judgment entered accordingly, filed, and entered.

Jan. 21, 1927. Stipulation filed, agreeing that judgment of $4,863.04 hereinbefore entered in favor of plaintiff, be vacated.

Jan. 21, 1927. Order of court filed and entered vacating the judgment entered on Nov. 23, 1926, and entering judgment in favor of the defendant with costs.

Jan. 21, 1927. Request for findings of fact and conclusions of law and the action of the court with reference thereto.

Jan. 25, 1927. Assignments of error filed.

Jan. 25, 1927. Petition for writ of error filed.

Jan. 25, 1927. Order of court filed and entered allowing writ of error and fixing the bond for costs at the sum of $200.

Jan. 25, 1927. Citation with acceptance of service by W. J. Aiken issued.

3 Jan. 25, 1927. Stipulation for printing record filed.

Jan. 25, 1927. Writ or error allowed.

Jan. 27, 1927. Bond on appeal approved & filed.

Certified from the records this 28th day of January, 1927.

[SEAL.] J. WOOD CLARK, *Clerk.*

In United States District Court

Praecipe and statement of claim

(Filed January 22, 1926)

PRAECIPE

To J. WOOD CLARK, *Clerk:*
Issue summons in assumpsit returnable next return day.

JAMES WALTON,
Attorney for Plaintiffs.

STATEMENT OF CLAIM

James R. Tindle and The Union Trust Company of Pittsburgh, plaintiffs above named, bring this suit against D. B. Heiner, collector of United States internal revenue for the twenty-third district of Pennsylvania at Pittsburgh, to recover the sum of twenty thousand three hundred fifty-six and 85/100 ($20,356.85) dollars, with interests and costs upon a cause of action whereof the following is a statement:

I

Philander C. Knox died October 12th, 1921. At the time of his death he was a citizen of Pennsylvania and a resident of Pitts-
4 burgh, Allegheny County, in the western district of said State. His last will and testament was duly admitted to probate in the Orphans' Court of Allegheny County and, on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff, James R. Tindle, is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said State, and the plaintiff, The Union Trust Company of Pittsburgh, is a Pennsylvania corporation, with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, The Union Trust Company of Pittsburgh is authorized and empowered to act as executor, trustee, and in other fiduciary capacities.

II

The defendant, D. B. Heiner, is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the western district of Pennsylvania. Said Heiner, at the time of the grievance herein complained of and at the date of filing the complaint, is collector of United States internal revenue for the twenty-third district of Pennsylvania, which district comprises within its borders the county of Allegheny.

III

Within the time prescribed by law, the said Philander C. Knox, pursuant to the provisions of the act of Congress approved February 24, 1919, entitled "An act to provide revenue, to defray war expenses and for other purposes" (commonly known as the revenue act of 1918), duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV

In his said tax return taxpayer claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

March 1st, 1913, fair value		$120,000.00
Depreciation sustained	$3,000.00	
Selling price	70,000.00	
		73,000.00
Loss		$47,000.00

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214 (a) 5, of the said revenue act of 1918, which reads:

"That in computing net income there shall be allowed as deductions—

* * * * * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

6 V

The facts with reference to the said transaction are that in the years 1887–1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish; however, the United States revenue field agent

who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established by A. & S. Wilson Company, one of the oldest firms of contractors in Pittsburgh. They show a cost appraisal of the residence as of the date of construction in the aggregate amount of $119,458.00. Similarly, with respect to the stable, they show the reproductive cost as of the date of construction to be $10,226.00.

About the year 1901, the Senator having been elected to the United States Senate, he leased the entire property to Mr. W. E. Corey, former president of the United States Steel Corporation, for a
7 period of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having a duration of ten years and providing for an annual rental of sixty-five hundred ($6,500.00) dollars. This lease was followed by a third lease dated April 1st, 1915, having a duration of one year for a stated annual rental of six thousand ($6,000.00) dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

As a part of the transaction Hammett was required to turn over to the Senator the equivalent of $9,500.00 advance rental collected by him on a garage property, which garage property represented part consideration in the transaction. The field agent held that such sum constituted additional income to the Senator and made adjustment accordingly (page 3 of his report).

8 The field agent made a comptation of his own of the consideration received by the Senator, taking into consideration accrued taxes, interest, etc., and arrived at the amount of $64,206.79 (page 3 of his report). For the purpose of this suit, it is admitted that the consideration as found by the field agent is correct, provided that there be added thereto the $9,500.00 hereabove mentioned.

VI

Thereafter, as the result of the examination of plaintiffs' tax liability by the said United States Field Agent J. B. Harmon, plaintiffs were advised of a proposal to assess an alleged additional tax in the

sum of $19,659.73. The said field agent, as pretended justification for the imposition of the proposed additional tax, asserted that taxable income shall be increased $56,500.00 In his official report, of which plaintiffs have been given a copy, he makes the following explanation:

"In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:

Disallowance of loss on sale of former residence	$47,000.00	
Rent for the year 1921 received in 1920	9,500.00	
		56,500.00
Corrected net income		$94,156.92"

9

VII

Thereafter, under date of September 27th, 1924, symbols IT: PA-5, CTN-505, the Commissioner of Internal Revenue advised plaintiffs that the conclusions of the field agent had been confirmed and that there was due from plaintiffs a pretended deficiency in tax of the aforesaid sum of $19,659.73.

VIII

Thereafter, on or about January 23rd, 1925, the defendant, as collector of United States internal revenue, demanded payment of the said sum of $19,659.73 alleged additional income tax from plaintiffs. Said amount was paid by plaintiffs to defendant on February 2nd, 1925, and such payment was made under protest and under duress, such duress consisting of threats by said defendant Heiner to impose penalties, levy distraint, and seize plaintiffs' property.

IX

Thereafter, on June 1st, 1925, plaintiffs duly filed with the defendant as collector of internal revenue for the twenty-third Pennsylvania district at Pittsburgh, on Form 843, the form prescribed by the Treasury Department, a claim for refund of the said amount of $19,659.73. A copy of said claim is attached hereto, designated "Exhibit A." There is imprinted thereon these words, as follows—

"Important.—File with the collector of internal revenue where assessment was made."

10

X

The said claim for refund was rejected by the Commissioner of Internal Revenue on August 20th, 1925, for the alleged reason that the loss claimed arose in a transaction not entered into for profit. At the time of filing this complaint, the said sum of $19,659.73 has not been refunded nor has any part thereof.

XI

Plaintiff avers that there existed no warrant in fact or in law for the disallowance and exclusion by the aforesaid taxing authorities of said $47,000.00 loss suffered on the sale of said property as a deduction in the computation of taxable income, upon the alleged theory that loss arose from a transaction not entered into for profit,—

(2), nor for the imposition and collection of $19,659.73 alleged additional tax as a consequence thereof—

(3), nor for assuming that the selling price of the property was less than its cost; when, as a matter of truth and fact, the cost of the property was not less than $172,401.00—

(4), nor for assuming that the fair market value of the property at March 1st, 1913, was not in excess of $65,000.00; when, as a matter of truth and fact, the fair market value of the property at said date was not less than $125,000.00—

(5), nor for assuming that $9,500.00 received by taxpayer was taxable income because taxpayer's grantee had collected a like
11 amount as advanced rental when, as a matter of truth and fact, such sum was part of the consideration received for the sale.

XII

Plaintiffs further aver that the amount of loss correctly and properly deductible in the computation of the tax liability is—

Fair market value of property at March 1st, 1913		$125,000.00
Consideration received:		
As computed by field agent	$64,206.79	
Additional consideration	9,500.00	
		73,706.79
Deductible loss		51,293.21

XIII

When the true and correct amount of the deductible loss from the aforesaid sale, to wit, the said sum of $51,293.21, is employed, the amount of tax properly refundable is shown to be $20,356.85, all of which is set forth in the following computation:

Taxable income employed by field agent and adopted by commissioner		$94,156.92
Amount of loss deductible	$51,293.21	
Amount erroneously added to income as rent	9,500.00	
		60,793.21
Correct taxable income		33,363.71
12 Tax previously paid:		
Paragraph III, *supra*	$2,991.68	
Paragraph VIII, *supra*	19,659.73	
		$22,651.41
Tax on $33,363.71		2,394.56
Amount refundable		$20,356.85

XIV

Under sections 1019 and 1020 of the revenue act of 1924, plaintiffs may be allowed interest at the rate of six per centum per annum on the said sum of $20,356.85, from the date of payment thereof, to wit, from February 2nd, 1925.

XV

This is a suit of a civil nature at common law and the matter in controversy, exclusive of interest, exceeds the sum of $3,000.00. The cause of action herein set forth arises under the laws of the United States for the assessment and collection of internal revenue.

Wherefore, plaintiffs pray judgment of the defendant in the sum of twenty thousand, three hundred fifty-six and 85/100 ($20,356.85) dollars with interest, together with the costs of this suit.

JAMES WALTON,
Attorney for Plaintiffs.

13 *Duly sworn to by Charles E. Young. Jurat omitted in printing.*

EXHIBIT A

(Copy of claim for refund)

(Execute separate form for each tax period)

Claim for refund of taxes illegally collected

STATE OF PENNSYLVANIA,
County of Allegheny, ss:

Estate of Philander C. Knox, deceased, c/o Union Trust Company, executor, Pittsburgh, Pa.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer
14 named, and that the facts given below with reference to said statement are true and complete:

1. Business in which engaged. Individual.
2. Character of assessment or tax. 1920 income.
3. Amount of assessment or stamps purchased (alleged additional), $19,659.73.
4. Reduction of tax liability requested (income and profits tax). Not applicable.
5. Amount to be abated. Not applicable.
6. Amount to be refunded (or such greater amount as is legally refundable), $19,659.73.
7. Dates of payment (see collector's receipts or indorsements of canceled checks). February 2nd, 1925.

8. District in which return (if any) was filed. 23rd Penna., Pittsburgh.

9. District in which unpaid assessment appears. Not applicable.

10. Amount of overpayment claimed as credit. Not applicable.

11. Unpaid assessment against which credit is asked; period from. Not applicable.

Deponent verily believes that this application should be allowed for the following reasons:

Taxpayer attaches hereto a full and complete statement of the reasons why refund in the above-stated amount should be made. Such statement, together with the exhibits attached thereto are hereby referred to and specifically made a part of this claim for refund.

Address of taxpayer's attorney: James Walton, Southern Building, Washington, D. C.

THE UNION TRUST COMPANY OF PITTSBURGH,
By (Signed) CHARLES E. YOUNG,
Co-Executor, Asst. Trust Officer.

Sworn to and subscribed before me this 1st day of June, 1925.
(Signed) JESSIE A. ROBERTSON,
Notary Public.

In the matter of Philander C. Knox, deceased, Union Trust Company, executor, Pittsburgh, Penna. 1920 income tax

Taxpayer's statement of the reasons why refund must be made

I

A report of examination by Field Agent J. B. Harmon of the Pittsburgh revenue office, a copy of which was delivered to the executor on January 21st, 1924, advises taxpayer of a proposal to assess him with an additional tax in the amount of $19,659.73. A copy of this field agent's report is attached hereto as Exhibit A and the essential part thereof with reference to this particular matter reads as follows:

"In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

Disallowance of loss on sale of former residence	$47,000.00	
Rent for the year 1921 received in 1920	9,500.00	56,500.00
Corrected net income		$94,156.92"

II

Thereafter the Commissioner of Internal Revenue at Washington, D. C., under date of July 24th, 1924, symbols IT:PA:5 CTN–505, duly advised the taxpayer of a proposal to assess an alleged deficiency in tax amounting to $19,659.73. This letter was on the usual Form NP–1, and the essential part of it reads:

"Additional tax, $19,659.73

"1920

"Verification of the books of account and records of Philander C. Knox as shown by the supplemental report of the revenue agent dated March 29, 1924, has been approved.

"You are advised that the action taken by the revenue agent in regard to the disallowance of the loss on the sale of his residence has been sustained."

17

III

Thereafter, on or about January 23rd, 1925, the collector of internal revenue at Pittsburgh, Pa., made due demand for the payment of the aforesaid sum of $19,659.73, which amount was paid by the executor of the deceased taxpayer on February 2nd, 1925, all of which appears from the collector's receipt, a copy of which reads:

Receipt for payment of taxes. Original. Addl. income tax

Collector's office, 23rd district of Penna., at Pittsburgh, Pa. Date 2/2/25. Check; year 1920

Name and address of taxpayer: Philander C. Knox, deceased % Union Trust Co., executor, Pittsburgh, Pa.

Amount $19,659.73. 1924 addl.

Jan. 186 P.

Paid Feb. 2, 1925. Int. rev. col. office, 23rd district, Pgh., Pa.

IV

Taxpayer respectfully shows that the field agent erred, that the commissioner's office erred in adopting the conclusions of the field agent, and that the action of the collector of internal revenue at Pittsburgh in insisting upon the payment of the alleged

18 additional tax was incorrect, not in accordance with the facts, and contrary to law, in the following particulars:

(1) In assuming that the selling price of the property was less than its cost; whereas, as a matter of truth and fact, the cost of the property, the loss upon the sale of which is proposed to be disallowed, was not less than $124,206.79.

(2) In assuming that the market price of the property at March 1st, 1913, was not in excess of $65,000.00; whereas, as a matter of

truth and fact, the market value of the property at said date was not less than $120,000.00.

(3) In presuming to add and include as taxable income an amount of $9,500.00 paid to the taxpayer by the purchaser of the property, which $9,500.00 represented advance rent collected by said purchaser on property which he traded to the taxpayer as part consideration for the taxpayer's property. As a matter of fact and law, this $9,500.00 was income of the taxpayer's grantee when received by him and is not, in any sense, taxable income to your petitioner; notwithstanding all of which the field agent has so computed it and his computation has been tentatively approved by the office of the Commissioner of Internal Revenue.

It thus appearing that the field agent's proposed increase of taxable income is erroneous, it necessarily follows that the alleged additional income tax required to be paid thereon was not lawfully due and that the amount thereof should be refunded.

19 EXHIBIT A

Copy of field agent's report

(Dated January 18, 1924)

In the matter of Philander C. Knox, deceased, Union Trust Company, executor, Pittsburgh, Penna. 1920 income tax

* * * * * * *

Note: If conference is desired, please arrange for an appointment. Mail to 802 Chamber of Commerce Bldg. Phone Smithfield 2438.

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
OFFICE OF INTERNAL REVENUE AGENT,
IN CHARGE PITTSBURGH DIVISION,
January 18, 1924.

In re: P. C. Knox, % Union Trust Company, executor, Pittsburgh, Pa. Date of report: January 11, 1924. Year examined: 1920

SIRS: There is transmitted herewith copy of report covering examination recently made by a representative of this office concerning your income-tax liability.

No remittance should be made until you receive notice of assessment from the collector of internal revenue for your district.

20 It is desired that every opportunity be afforded you to present any objections or any additional information which you believe might affect the result of the final decision of the Commissioner of Internal Revenue at Washington, D. C. The original of this report will therefore be held in this office for a period not to exceed twenty days from the date of this letter in order that you

may, if you so desire, present any protests, briefs, or letters should be forwarded in duplicate to this office. These papers will receive consideration before the report with all papers pertaining to the same is transmitted to Washington for final action by the Commissioner of Internal Revenue. If you agree to the findings of the examining officer, the report will be forwarded to the department at once.

Please acknowledge receipt by return mail, indicating whether protest will be submitted.

Respectfully,

ALBERT W. SMITH,
Internal Revenue Agent in Charge.

In re: P. C. Knox, % Union Trust Company, executor, Pittsburgh, Pa. January 11, 1924

Examining officer, J. B. Harmon.
Examination commenced December 20. Suspended.
Examination completed January 11; 7½ days.
Internal revenue agent in charge, Pittsburgh, Pa.

21 An investigation of records in connection with the income-tax liability of the above-named individual for the calendar year 1920 discloses the following:

Summary

Year	Form	Additional tax
1920	1040	$19,659.73

Authority for examination: Photostat copy of 1920 return, which is attached hereto.

Lack of records in this district prevented a thorough examination, although it is extremely doubtful that sufficient records could be assembled for such an examination of this case.

Your examiner has delved into all the available records in this city and has made quite a thorough examination of the sale of taxpayer's former residence reported in his 1920 return.

Marital exemption: Married, living with wife.

Wife's income: Separate return, with no claim for exemption.

The valuation placed by the city of Pittsburgh on the former residence property of the taxpayer for the year 1913 and subsequent years, including the year 1920, was as follows:

Land	$72,630.00
2 story stone brick dwelling	40,000.00
Frame stable	3,000.00
Total	$115,630.00

Your examiner finds upon investigation that the land included in the above cost the taxpayer $16,400.00 in three lots bought in
22 1886, 1887, and 1892. The cost to the taxpayer for the erection of the buildings was probably $50,000.00 or more.

The real estate agent who sold the taxpayer's former residence property stated that the price at which it was sold, $65,000.00, was the market value of the property at March 1, 1913, and that a greater price could not be obtained for it at that date. The distribution of value at March 1, 1913, would probably be land, $40,000.00; dwelling, $24,000.00; and stable, $1,000.00.

In the sale of his property, the taxpayer took in payment a $90,000.00 property and assumed a mortgage of $40,000.00 on same, leaving him an equity of $50,000.00, which is confirmed by $50.00 of revenue stamps of deed received, and in addition, he received $15,000.00 cash. The former owner of the $90,000.00 property had received $9,500.00 in advance for rent of the large garage building on his property for the year 1921. This rent he had to turn over to the taxpayer at the time of closing the sale in November of 1920. The taxpayer apparently thought he had included this advance rent in the reported selling price of his property at $70,000.00, but investigation of the records of the real estate agent who sold the property for him discloses the fact that he received the following in settlement for the sale:

Equity in new property	$50,000.00	
Cash	15,000.00	
Accrued interest on $40,000.00 mortgage from 6/12/20 to 11/15/20	1,020.00	
23 Pro rata amount of 1920 city and county taxes on his former residence property	404.40	
		$66,424.40
Less pro rata amount of 1920 city and county taxes on property taken in payment	152.61	
Revenue stamps on deed given	65.00	
Commission for selling	2,000.00	
		2,217.61
Net proceeds or selling price		64,206.79

Depreciation from March 1, 1913, to Dec. 31, 1919, is as follows:

Brick stone dwelling—	
$24,000.00 at 2% equals	$480.00 per yr.
Frame stable—	
$1,000.00 at 5% equals	50.00 per yr.
Total	530.00 per yr.

$530.00 per year for 6⅞ yrs. equals $3,621.67.

In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

24	Disallowance of loss on sale of former residence	$47,000.00	
	Rent for year 1921 received in 1920	9,500.00	
			$56,500.00
	Corrected net income		94,156.92
	Dividends	66,544.00	
	Personal exemption	2,000.00	
			68,544.00
	Amount subject to normal tax		25,612.92
	Amount subject to normal tax of 4%		4,000.00
	Amount subject to normal tax of 8%		21,612.92
	Normal tax at 4%	160.00	
	Normal tax at 8%	1,729.03	
	Surtax per schedule	20,762.18	
	Total tax	22,651.21	
	Previously assessed	2,991.48	
	Additional tax	19,659.73	

The Union Trust Co. of Pittsburgh, Pa., one of the executors of the now deceased taxpayer, has been advised of the findings of this examination and has protected it in a letter to be mailed in to this office.

(Signed) J. B. HARMON,
Internal Revenue Inspector.

25 *To the within defendant:*

You are required to file an affidavit of defense to this statement of claim within 15 days from the service hereof.

JAMES WALTON,
Attorney for Plaintiffs.

Fulton Building, Pittsburgh, Penna.

In United States District Court

Affidavit of defense

(Filed February 25, 1926)

STATE of PENNSYLVANIA,
County of Allegheny, ss:

D. B. Heiner, being duly sworn according to law, declares and says that he is the defendant in the above entitled cause and that he has a just, true, complete, and legal defense to the whole of plaintiff's claim of the character and nature as follows:

1. The averments of paragraph 1 of plaintiffs' statement of claim are admitted.

2. The averments of paragraph 2 of plaintiffs' statement of claim are admitted.

3. The averments of paragraph 3 of plaintiffs' statement of claim are admitted.

4. The averments of paragraph 4 of plaintiffs' statement of claim are admitted.

5. The averments of paragraph 5 of plaintiffs' statement of claim are admitted.

6. The averments of paragraph 6 of plaintiffs' statement of claim are admitted.

26 7. The averments of paragraph 7 of plaintiffs' statement of claim are admitted.

8. The averments of paragraph 8 of plaintiffs' statement of claim are admitted.

9. The averments of paragraph 9 of plaintiffs' statement of claim are admitted.

10. The averments of paragraph 10 of plaintiffs' statement of claim are admitted but in mitigation thereof the defendant avers that on or about January 25, 1926, the said claim for refund was allowed in the sum of $4,863.04 and that the plaintiff, the Union Trust Company of Pittsburgh, executor, etc., was notified of such allowance by letter from C. R. Nash, assistant to the commissioner, dated January 25, 1926, of which a copy was sent to Mr. J. M. Cumming, Southern Building, Washington, D. C., of counsel for the plaintiffs and so expects to be able to prove at the trial of this case.

11. The averments of paragraph 11 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the revenue act of 1918 there was no deductible loss suffered on the sale of said property; (2) that the said law justified the imposition and collection of the tax of $19,659.73, less the overassessment of $4,863.04, as above set out; (3) that there has been no assumption that the selling price of the property was not less than its cost; (4) that the fair market value of its property on March 1, 1913, in the claim for refund filed by the plaintiffs is stated at not less than $120,000, while in the complaint herein filed the same value of this property is stated at not less than $125,000; (5) that the contention of

27 the taxpayer in regard to the $9,500 has been conceded and this amount is the principal basis of the refund of $4,863.04 as above set out, all of which defendant expects to be able to prove at the trial of this case.

12. The averments of paragraph 12 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the revenue act of 1918 and regulations promulgated pursuant to law, no loss was suffered from the sale of this property, and so expects to be able to prove at the trial of this case.

13. The averments of paragraph 13 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the provisions of the revenue act of 1918 and regulations promulgated in pursuance to law, there was no deductible loss for income tax purposes from the sale of this property, and that the only sum refundable to the plaintiffs herein is the sum of $4,863.04, which was made the subject of certificate of overassessment No. 877468 and of which plaintiffs were advised on January 25, 1926, the said amount being arrived at as follows:

Tax assessed (original tax)	$2,991.68
Additional assessment, January, 1925, list, page 13, line 6	19,659.73
Total assessment	22,651.41
Tax liability	17,788.37
Overassessment	4,863.04

and so expects to be able to prove at the trial of this case.

28 14. The averments of paragraph 14 of plaintiffs' statement of claim are denied in so far as it is alleged that interest may be allowed at the rate of 6% per annum on said sum of $20,356.85, and in answer thereto the defendant avers that the plaintiffs are entitled to interest at the rate of 6% per annum upon any amount recovered in this action, but that the amount so recovered, if any, cannot exceed the sum of $19,659.73, less $4,863.04 heretofore allowed plaintiff as above set out—that is, $14,796.69—and so expects to be able to prove at the trial of this case.

15. The averments of paragraph 15 of plaintiffs' statement of claim are admitted.

I, therefore, owe the plaintiff nothing.

All of the above stated facts are correct and true and defendant avers and expects on the trial of this case to be able to prove the same.

D. B. HEINER.

Subscribed and sworn to before me this 24th day of February, 1926.

GERTRUDE HORTON BERGER,
[SEAL.] *Dep. Clerk U. S. Dist. Court.*

29 In United States District Court

Opinion

(Filed Nov. 23, 1926)

THOMSON, J.: This is an action brought by the executors of the will of Philander C. Knox, deceased, against the collector of internal revenue of this district, to recover additional tax for the year 1920, the amount of which was assessed by the Government, and paid by the decedent under protest.

The facts in the case are briefly these: Senator Knox, decedent, built, in about the year 1887, a residence in the city of Pittsburgh, at a cost of approximately $172,000.00. The building was occupied by Mr. Knox as his residence from the time it was built until 1901, when he was elected to the United States Senate. At that time the Senator moved his residence to the Schenley Hotel, Pittsburgh, from which residence he voted until the time of his death in 1921. From 1901 until 1920 he leased the property to various tenants, and in 1920 sold it to one James H. Hammett for the sum of $73,706.79.

The plaintiffs contend that the property was worth in the neighborhood of $120,000.00 on March 1, 1913, and claim as a loss the difference between that sum and the amount for which it was sold in 1920, and seek to deduct that amount from the income of the taxpayer for the year 1920 under section 214 (a) (5) of the revenue act of 1918. This particular section of the law reads as follows:

"That in computing net income there shall be allowed as deductions:

30 "5. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business."

The defendant's contention is that the purchase of the property by a taxpayer for his residence is not a transaction entered into for profit under the revenue acts. He also contends that the property had the same value in 1913 that it had in 1920, at the time of its sale, and that hence no deductible loss in any case was sustained by the taxpayer.

The evidence justifies the finding which I now make, that the fair value of the property as of March 1, 1913, was $120,000.00, and if the loss in the sale is a deductible loss under the section of the revenue act above recited, the difference between that value and the price at which the property sold would represent that loss. We are, therefore, confronted with the question of the proper interpretation of the law in question under the facts as they are conceded to be. The provisions of section 5 are also contained in the revenue acts of 1921, 1924, and 1926. Regulations 45 as promulgated April 17, 1919, provided as follows:

"Art. 141. Losses. * * * A loss in the sale of an individual's residence is not deductible."

This regulation was amended on January 28, 1921, to read as follows:

"Art. 141. Losses. * * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

31 This same provision is contained in regulations 62, under the revenue act of 1921, and in regulations 65, under the revenue act of 1924.

The question is, Is the purchase of property by a taxpayer for his residence a transaction entered into for profit; if not, where the taxpayer ceases to use the property as his residence and leases it to another as a residence, is the status changed, making the renting of the property a new transaction entered into for profit?

In the Solicitor's Law Opinion 780 (1 Cumulative Bulletin 117) it is said:

"The expression 'transaction entered into for profit' clearly means a complete business venture from inception to conclusion. The de-

duction allowed is for losses sustained in any transaction 'entered into' for profit. The intent to make a profit must have existed at the commencement of the enterprise or the right to deduct losses incurred is not within the contemplation of the statute. To construe the words 'transaction entered into for profit' as referring only to the conclusion of the venture—that is, the sale of the property—would result in a practical nullification of the statute. * * *

"Where a loss incurred in the sale of residential property is deductible in arriving at net income must be determined by the object or intent of the individual in buying or constructing the property."

The provision of the law under which the plaintiff claims
32 was not in any revenue act prior to 1918, but has been in all the revenue acts from 1918 to and including the act of 1926. Except in one appeal before the Board of Tax Appeals no case is reported in the courts interpreting this provision. In the case of the appeal of John J. Madden, 2 U. S., Board of Tax Appeals, page 702, decided on September 30, 1925, the board held that the building of a house to meet the taxpayer's requirements for a home was not a transaction entered into for profit. In office decision 1148 (5 Cumulative Bulletin, page 141) it is said:

"It is held that if a loss is deductible at all it is deductible under section 214 (a) 5 of the revenue act of 1918 as a loss sustained in a transaction entered into for profit. However, the mere renting of property purchased without the intention at the time of purchase of making a pecuniary profit thereon does not constitute a 'transaction entered into for profit' within the meaning of the statute, and as the taxpayer in the instant case purchased the property for a home, it was not his intention at the time to subsequently sell it for profit. It is therefore held that any loss sustained is not deductible for the purposes of the revenue act of 1918."

Ever since the act of 1918 was passed the regulations have provided that a loss in the sale of property purchased by a taxpayer for his residence is not a loss in a transaction entered into for profit. The original regulations 45 provided that a loss in the sale of an individual's residence is not deductible. The amendment of
33 January 28, 1921, provided that a loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. The one is an amendment of the other and can scarcely be said to have effected any material change. Both relate to the beginning of the transaction, viz, the purchase or construction of the property in question.

The decisions of the department have been uniform and all have held the loss in such cases not a deductible loss. The reinactment of the law year after year without change must be taken as an indication not only to continue in force the existing law but to adopt the practice of the department in interpreting and applying it. It was said in United States *v.* Anderson, 46 Sup. Ct., 131:

"By thus adopting without material change, the corresponding provisions of earlier acts, Congress might have been deemed to have recognized and adopted the established practice of the department interpreting and applying them. National Lead Co. *v.* United States, 252 U. S., 140."

See also Provost *v.* United States, 46 Sup. Ct., 152.

The issuing of regulations by the Secretary of the Treasury is subsequently made his duty by the revenue act of 1918, and other revenue acts, and the Supreme Court has held that it is settled by the decisions of that court that a regulation by a department of Government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is
34 confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. United States *v.* Grimaud, 220 U. S. 506, and many other cases.

It appears to me that the rulings of the department are in harmony with the provisions of the law. The transaction in question is one which began with the purchase and ended with the sale. The transaction was the ownership of the property and was ended when the property was sold. It cannot be fairly said that this was entered into for profit but was entered into for the purpose of providing a home for the taxpayer. The transaction which was begun by the leasing of the property ended when the lease was ended, and it is not suggested that this was a loss. This is true of each succeeding lease. The transaction which was ended by the sale of the property seems clearly to have been the one which was begun by its purchase.

I am, therefore, compelled to hold that the plaintiffs' position that the loss claimed by the decedent as a deduction from taxable income under section 214 (a) of the revenue act of 1918, cannot be sustained. It appears, however, that in June, 1925, the plaintiffs filed with the defendant as collector of internal revenue, a claim for refund of the amount of taxes which had been paid under protest, which claim was denied except as to the amount of $4,863.04, which sum was allowed, but has not in fact been paid by the Government. The allowance of this claim is conceded by the defendant in the affidavit of defense filed.

35 Plaintiff is, therefore, entitled to judgment in this action in the sum of $4,863.04 with interest from the date of payment thereof, to wit, from February 2, 1925.

Judgment may, therefore, be entered accordingly.

In United States district court

Plaintiff's request for findings of fact, conclusions of law, and order of court

(Filed January 21, 1927)

Comes now the plaintiff, by James Walton, Esquire, its counsel, and, in accordance with rule 38 of the United States Supreme Court

as revised, paragraph 2, adopted June 8, 1925, and effective July 1, 1925, considering itself aggrieved by the findings of fact and conclusions of law as made and handed down by the honorable court in the above-entitled cause on the 23rd day of November, 1926, and considering the facts hereafter set forth to have been proven and deeming them material to a hearing and determination of this cause upon a writ of error to the Circuit Court of Appeals and similarly so considering with respect to the conclusions of law hereafter set forth, does, therefore, respectfully request the honorable court to find as facts and as conclusions of law as follows:

FINDINGS OF FACT

I

Philander C. Knox died October 12th, 1921. At the time of
36 his death he was a citizens of Pennsylvania and a resident of Pittsburgh, Allegheny County, in the western district of said State. His last will and testament was duly admitted to probate in the Orphans Court of Allegheny County, and on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff James R. Tindle is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said State, and the plaintiff The Union Trust Company of Pittsburgh is a Pennsylvania corporation with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, the Union Trust Company of Pittsburgh is authorized and empowdered to act as executor, trustee, and in other fiduciary capacities.

II

The defendant D. B. Heiner is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the western district of Pennsylvania. Said Heiner, at the time of the grievances set forth in and at the date of filing the statement of claim is collector of United States internal revenue for the twenty-third district of Pennsylvania, which district comprises within its borders the county of Allegheny.

III

Within the time prescribed by law, the said Philander C. Knox,
37 duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV

In his said tax return Mr. Knox claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

March 1st, 1913, fair value		$120,000.00
Depreciation sustained	$3,000.00	
Selling price	70,000.00	
		73,000.00
Loss		$47,000.00

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214 (a), 5, of the revenue act of 1918, which reads—

"That in computing net income there shall be allowed as deductions—

* * * * * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

V

38 The facts with reference to the said transaction are that in the years 1887–1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish; however, the United States revenue field agent who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established as of the date of construction to be the sum of $119,458.00. Similarly, with respect to the stable, the cost as of the date of construction is fixed at $10,226.00.

About the year 1901 the Senator, having been elected to the United States Senate, leased the entire property to Mr. W. E. Corey, former president of the Unit'd States Steel Corporation, for a period of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having

a duration of ten years and providing for an annual rental of sixty-
five hundred ($6,500.00) dollars. This lease was followed by
39 a third lease dated April 1st, 1915, having a duration of one
year for a stated annual rental of six thousand ($6,000.00)
dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

VI

I find as a fact that the cost of the entire property was approximately $172,000.00.

VII

I find as a fact that the March 1, 1913, fair market value of the entire property was $120,000.00.

VIII

I find as a fact that the total consideration which Mr. Knox received for the entire property was $73,706.79.

40 IX

The Commissioner of Internal Revenue, in auditing Senator Knox's tax return, made two changes or adjustments:

First, he disallowed the $47,000.00 claimed loss on the sale of the property at 5044 Ellsworth Avenue; and,

Second, he added $9,500.00 to income which he claimed was rental.

By this process $19,659.73 alleged additional tax was computed against the taxpayer, it was duly assessed, it was paid under protest, a claim for refund was filed, and the claim for refund was rejected by the Commissioner of Internal Revenue on August 20, 1925. This suit was filed January 22, 1926.

X

The plaintiff's contention with respect to the $9,500.00 item is conceded by the defendant and, subsequent to the date of the trial, a refund was made to the plaintiff to the extent such item was a factor in the alleged additional tax, to wit, $4,863.04.

CONCLUSIONS OF LAW

I

I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence terminated what originally may have been a transaction entered into not for profit.

41 II

I find, as a conclusion of law, that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same constituted a new transaction—a transaction entered into for profit, and that the loss suffered in the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income.

III

I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913, fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21.

IV

I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States Constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto.

V

I find, as a conclusion of law, that plaintiff is entitled to a judgment against the defendant in the amount sued for as set
42 forth in the statement of claim, together with costs and statutory interest, subject, however, to adjustment and modification in the amount of $4,863.04 which has already been refunded to the plaintiff and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21.

Respectfully submitted.

JAMES WALTON,
Attorney for Plaintiff.

JANUARY 17, 1927.

In United States District Court

Order of court

(a) Adopting plaintiff's requested findings of fact.
(b) Rejecting plaintiff's requested conclusions of law.

And now, to wit, on this 21st day of January, 1927, this cause comes before the court upon the plaintiff's request for specific findings of fact and conclusions of law, and the court being fully advised in the premises and having heretofore, on November 23, 1926, handed down its opinion in the case, does therefore find and decline to find as follows:

Each and every one of plaintiff's requested findings of facts, numbered I to X, inclusive, are approved and adopted in their entirety, the same being not inconsistent with the court's opinion heretofore filed.

Each and every one of plaintiff's requested conclusions of
43 law, numbered I to V, inclusive, are disapproved and rejected in their entirety, the same being contrary to the court's opinion heretofore filed.

W. H. S. THOMSON, *Judge.*

Eo die, plaintiff objects to the above action of the court in rejecting his requested conclusions of law and at his instance exception noted.

W. H. S. THOMSON.

In United States District Court

Judgment

(Filed Jan. 21, 1927)

And now, to wit, January 21, 1927, it appearing by stipulation of counsel herewith filed, that the sum of $4,863.04, the amount conceded to be due plaintiff in the affidavit of defense, was paid by the defendant to the plaintiff prior to the previous entry of judgment herein; by virtue of this fact and under said stipulation, it is hereby ordered and adjudged that the said judgment be, and the same is hereby vacated and set aside. Thereupan counsel for plaintiff presents to the court certain requests for findings of fact and conclusions of law, which requests I have answered and file the same herewith, as if answered and filed with the original opinion; and now, the day and year aforesaid, judgment is hereby entered in favor of the defendant with costs.

W. H. S. THOMSON, *Judge.*

44 In the United States District Court

Assignments of error

(Filed Jan. 25, 1927)

The plaintiff in this action, in connection with his petition for a writ of error, makes the following assignments of error which he avers occurred upon trial of the cause, to wit:

I

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered I, as follows:

"I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence, terminated what originally may have been a transaction entered into not for profit."

II

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered II, as follows:

"I find, as a conclusion of law that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same, constituted a new transaction,—a transaction entered into for profit and that the loss suffered on the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income."

45 III

The court erred in declining to make and rejecting plaintiffs requ'sted conclusion of law numbered III, as follows:

"I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913, fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21."

IV

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered IV, as follows:

"I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto."

V

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered V, as follows:

"I find, as a conclusion of law, that plaintiff is entitled to a
46 judgment against the defendant in the amount sued for as set forth in the statement of claim, together with costs and statutory interest, subject, however, to adjustment and modification in the amount of $4,863.04, which has already been refunded to the plaintiff, and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21."

Wherefore the plaintiff prays that the judgment of the District Court may be reversed.

JAMES WALTON,
Attorney for Plaintiff.

PITTSBURGH, PENNA., *January 25, 1927.*

In United States District Court

Stipulation re transcript of record

And now, to wit, January 24th, 1927, it is hereby stipulated and agreed by and between counsel for plaintiff and counsel for the defendant that the following be printed as and constitute the record on writ of error in the above case before the United States Circuit Court of Appeals for the Third Circuit, viz:

1. Docket entries.
2. Statement of Claim.
3. Affidavit of defense.
4. Request for findings of fact and conclusions of law ex parte plaintiff.
5. Opinion of the court filed November 23, 1926.

47 6. Supplemental opinion of the court filed January 21, 1927, together with order of judgment in favor of the defendant which is a part thereof.

7. Assignments of error.
8. This stipulation.

JAMES WALTON,
Attorney for Plaintiff.
W. J. AIKEN,
Asst. U. S. Attorney,
Attorney for Defendant.

[Clerk's certificate to foregoing transcript omitted in printing.]

48 [Minute entry of argument and submission, March 8, 1927, omitted in printing.]

49 In United States Circuit Court of Appeals for the Third Circuit

No. 3594. March term, 1927

JAMES R. TINDLE AND THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of Philander C. Knox, deceased, plaintiffs below, plaintiffs in error

vs.

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE, DEFENDANT BELOW, defendant in error

In error to the District Court of the United States for the Western District of Pennsylvania

Before Buffington, Woolley, and Davis, Circuit Judges

Opinion filed April 4, 1927

BUFFINGTON, circuit judge:

The case centres around the word "transaction"—"transaction entered into for profit"—as used in the revenue act of 1918 (40 Stat. c. 18, section 214, a 5) in respect to losses allowed as deductions in income tax returns. What, in point of fact, is the transaction we are here dealing with? Was it one Congress meant to cover by this section? Viewed as an entirety the transaction involved is this: In 1887–1888 the late Philander C. Knox bought ground in the city of Pittsburgh and built a residence thereon at a cost in all of $172,000. In 1920, he sold this property and residence for $73,706.79, so that taken as a whole, the transaction, begun in 1887 and ended in 1920, constitutes a single whole from the viewpoint of buying and selling, but when this single whose is considered from the standpoint of the use to which the property had, meanwhile, been put, it resolves itself into two distinct and wholly different transactions. First, the property was used by him as a residence; he built the house for that purpose and so used it until 1901. This transaction was therefore a distinctively home, residential, one. In 1901, however, he entered into national public life and gave up the property as a residence and never afterwards occupied it. He acquired a residence by living in a different ward of the city and retained it up to the time of his death for occasional residential and seasonal voting purposes,
50 and, as stated by counsel at the hearing, his regular winter residence was in Washington City, where he bought and occupied a home, and his summer residence in a home he owned at Valley Forge, Pennsylvania. With the ending of his occupation of his Pittsburgh home, he rented the same on long term leases. His first lease was in October, 1901, for three and a half years; later for

a term of ten years and thereafter for shorter terms, until the property was finally sold. With the giving up of his residence all sentimental connection in the use of the house as a home ended and thereafter the use of the property was by others under lease from him during the running of the first lease for three years, to wit from October 1, 1901, and then from April 1, 1905, for ten years. During the running of these leases he was of course unable to sell the property by reason of the use he was making of it and the leases he had given for his own profit. Such being the status of the transaction, the ordinary one of owning real estate for leasing purposes, the situation of the property under the second or ten year lease when the income tax law of 1913 was passed, was a distinctively non-residential and a distinctively business leasing of real estate for profit. We think we are justified in regarding the transaction here involved by its then and subsequent status. The situation was in no wise different than it would have been had he always owned and used the property for renting purposes and never for residential purposes, because the residential use had finally and forever ceased at the time of the passage of the income tax law. What then was the fact and status in money value of this property when the income tax law of 1913 was passed? It was a distinctively renting transaction and in this transaction was involved the use for renting of property of the agreed upon then value of $120,000. Any system of bookkeeping in this transaction would have had charged against it an investment of $120,000 represented by real estate and the rents upon the same would have been profits. What then would have been the result of this transaction when it was finally closed? Clearly instead of profits a loss represented by the shrinkage in value of the property during that time of $46,293.21.

But, assuming the situation was one where some might contend, as did the court below, that the language of Congress was intended to treat the transaction as a purchase and sale of property without reference to what its use was during the interim, it seems to us the opposite view might very reasonably be taken of holding Mr.
51 Knox's tenure as made up of two transactions, one, the residential one, which had ceased to exist long before and to which the law did not apply, the other, a purely business venture, unfortunate in its results, but one which the law fairly contemplated should be off-set against other items of income which the owner of the property sustained. It seems to us therefore with this double interpretation in the balance that the law would then resolve that uncertainty against the Government in favor of the taxpayer. Assured as we are that this latter transaction was one entered into and carried on for profit, the decedent in the assessment of his net income should have been allowed credit for the loss resulting therefrom.

The judgment below will therefore be reversed with instructions to enter judgment for the taxpayer's estate.

[File indorsement omitted.]

52 In United States Circuit Court of Appeals

[Title omitted.]

Judgment filed April 4, 1927

In error to the District Court of the United States, for the Western District of Pennsylvania.

This cause come on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be, and the same is hereby reversed, with instructions to the said District Court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

Per Curiam: BUFFINGTON, *Circuit Judge.*

[File endorsement omitted.]

53 In United States Circuit Court of Appeals

Mandate filed May 9, 1927

The President of the United States of America,
To the honorable the judges of the District Court of the United States for the Western District of Pennsylvania, greeting:

Whereas, lately in the District Court of the United States for the Western District of Pennsylvania, before you or some of you, in a cause between James R. Tindle and The Union Trust Company of Pittsburgh, coexecutors of the last will and testament of Philander C. Knox, deceased (plaintiffs below), plaintiffs in error; and D. B. Heiner, collector of United States internal revenue for the 23d district of Pennsylvania (defendant below), defendant in error, a judgment was entered in the said District Court on the twenty-first day of January, 1927, which judgment is of record in the office of the clerk of the said District Court, to which reference is hereby made, and the same is hereby expressly made a part hereof.

54 And whereas, in the present term of March, in the year of our Lord one thousand nine hundred and twenty-seven, the said cause came on to be heard before the said United States Circuit Court of Appeals on the said transcript of record and was argued by counsel:

On consideration whereof, it is now here ordered and adjudged by this court, that the judgment of the said District Court in this cause be, and the same is, hereby reversed, with instructions to the said District Court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

You, therefore, are hereby commanded that such execution and further proceeding be had in said cause, as according to right and

justice, and the laws of the United States, ought to be had, the said writ of error notwithstanding.

Witness, the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the ninth day of May, in the year of our Lord one thousand nine hundred and twenty-seven (1927).

SAUNDERS LEWIS, Jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

[File endorsement omitted.]

55 [Clerk's certificate to foregoing transcript omitted in printing.]

56 Supreme Court of the United States

Order allowing certiorari, filed October 24, 1927

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsed on cover:] File No. 32793. U. S. Circuit Court of Appeals, Third Circuit. Term No. 341. D. B. Heiner, collector of United States internal revenue for the twenty-third district of Pennsylvania, petitioner, *vs.* James R. Tindle and The Union Trust Company of Pittsburgh, coexecutors, etc., petition for writ of certiorari and exhibit thereto. Filed June 30th, 1927. File No. 32793.

○

Office Supreme C
FILE
JUN 30
CHARLES ELMORE

IN THE

United States Circuit Court of Appeals

FOR THE THIRD CIRCUIT.

NO. 3594. 341

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of Philander C. Knox, Deceased, Plaintiffs Below, Plaintiffs-in-Error,

v.

D. B. HEINER, Collector of United States Internal Revenue for the 23rd District of Pennsylvania, Defendant Below, Defendant-in-Error.

TRANSCRIPT OF RECORD.

Error to the District Court of the United States for the Western District of Pennsylvania, at No. 3432 Law.

JAMES WALTON,
1530 Park Building,
Pittsburgh, Pa.
Attorney for Plaintiff-in-Error.

JOHN D. MEYER,
United States Attorney,

W. J. AIKEN,
Assistant United States Attorney,
Attorneys for Defendant-in-Error.

SMITH BROS. CO. INC., LAW PRINTERS, 210-212 GRANT ST., PITTSBURGH, PA.

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Resp. sued for $20,000 alleged overpayment of income tax for 1920. He found for Resp, but CCA reversed. Question is whether a loss may be claimed on the sale of real property, first used as residence and later leased. The CCA held it could. Depends on

24(a)(3) Rev Act of 1918 Wis p. 5 + this →

Carried into later acts.

In 1887 Philander Knox built dwelling house in Pittsburgh for $72,000. He occupied this until 1901 when it ceased to be his residence. Thereafter he leased it. In 1913, its value was $120,000. In 1920 he sold it for $73,000. In his income tax for that year, he claimed the dif. between $120,000 value in 1913 and $73,000 as a loss. He paid under protest a tax which disallowed this and his estate sued for $20,000

CCA said:

1. Two transactions - one beginning in 1887 and other in 1901. The last was for profit and continued until the sale. It came within the statute

2. If not two separate transactions - since it might be held the transaction beginning "In . . . " [illegible] — then two phases of the same action (I quote freely & seek understandingly to paraphrase what is not perfectly clear to me) and the last gave it the character of profit which extended down to 1920.

WJ says:

1. A transaction ending with a sale must have been begun with a profit purchase, since if [illegible] not having entered (begun) by for profit, it does not come within statute

2. If the lease in 1901 began a new transaction what was property worth when it was first leased. That is important because the rule of McCaughn v. Ludington, 768/106 is that the basis for gain or loss of dep. between selling price and cost or value in 1913, whichever is lower. No telling what value was in 1901

3. If lease in 1901 was beginning the termination of lease was sale. The sale had nothing to do with it

4. Such [illegible] has always been held without the statute. Congress was clear. This confuses the law.

RECORD.

Among the Rolls, records and judicial proceedings had in the District Court of the United States for the Western District of Pennsylvania, at No. 3432 in Law, may be found the following words and figures:

IN THE DISTRICT COURT
OF THE UNITED STATES OF AMERICA
FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of PHILANDER C. KNOX, deceased,
Plaintiffs,
v.
D. B. HEINER, Collector of United States Internal Revenue for the 23rd District of Pennsylvania,
Defendant.
} Law No. 3432.

Docket Entries.

Jan. 22, 1926 Praecipe for summons in assumpsit and Statement of Claim filed.

Jan. 22, 1926 Summons in assumpsit issued returnable 1st Mon. of Feb. next.

Jan. 29, 1926 Summons returned served on D. B. Heiner, Collector of Internal Revenue, 23rd Dist. Pa. by handing to and leaving a true and attested copy

thereof with D. B. Heiner, personally at Pittsburgh, Jan. 23, 1926.

Feb. 2, 1926 Praecipe for appearance of John D. Meyer and W. J. Aiken for deft.

Feb. 25, 1926 Affidavit of Defense filed.

Mar. 10, 1926 Stipulation waiving Jury trial filed.

Mar. 10, 1926 Trial without a jury had; C. A. V.

Mar. 10, 1926 Witnesses sworn for Plff. (4)

Mar. 10, 1926 Motion of W. J. Aiken, for the court to render judgment for the defendant filed.

Mar. 10, 1926 Trial Mem. filed.

Nov. 23, 1926 Opinion entitling plaintiff to judgment in sum of $4,863.04 with interest from February 2, 1925 and judgment entered accordingly, filed and entered.

Jan. 21, 1927 Stipulation filed, agreeing that judgment of $4,863.04 hereinbefore entered in favor of plaintiff, be vacated.

Jan. 21, 1927 Order of Court filed and entered vacating the judgment entered on Nov. 23, 1926, and entering judgment in favor of the defendant with costs.

Jan. 21, 1927 Request for findings of fact and conclusions of law and the action of the court with reference thereto.

Jan. 25, 1927 Assignments of Error filed.

Jan. 25, 1927 Petition for Writ of Error filed.

Jan. 25, 1927 Order of Court filed and entered allowing Writ of Error and fixing the bond for costs at the sum of $200.

Jan. 25, 1927 Citation with acceptance of service by W. J. Aiken issued.

Jan. 25, 1927 Stipulation for printing record filed.

Jan. 25, 1927 Writ of error allowed.

Jan. 27, 1927 Bond on appeal approved & filed.

Certified from the records this 28th day of January, 1927.

J. WOOD CLARK,
Clerk.

[SEAL]

Praecipe and Statement of Claim.

Filed January 22, 1926.

PRAECIPE.

To J. WOOD CLARK, *Clerk*:

Issue summons in assumpsit returnable next return day.

JAMES WALTON,
Attorney for Plaintiffs.

STATEMENT OF CLAIM.

James R. Tindle and The Union Trust Company of Pittsburgh, plaintiffs above named, bring this suit against D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania at Pittsburgh, to recover the sum of Twenty thousand three hundred fifty-six and 85/100 ($20,356.85) dollars, with interests and costs upon a cause of action whereof the following is a statement:

I.

Philander C. Knox died October 12th, 1921. At the time of his death he was a citizen of Pennsylvania and a resident of Pittsburgh, Allegheny County, in

the Western District of said state. His last will and testament was duly admitted to probate in the Orphans' Court of Allegheny County and, on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff, James R. Tindle, is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said state, and the plaintiff, The Union Trust Company of Pittsburgh, is a Pennsylvania corporation, with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, The Union Trust Company of Pittsburgh is authorized and empowered to act as executor, trustee and in other fiduciary capacities.

II.

The defendant, D. B. Heiner, is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the Western District of Pennsylvania. Said Heiner, at the time of the grievance herein complained of and at the date of filing the complaint, is Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, which district comprises within its borders the County of Allegheny.

III.

Within the time prescribed by law, the said Philander C. Knox, pursuant to the provisions of the Act of Congress approved February 24, 1919, entitled "An Act to provide revenue, to defray war expenses

and for other purposes" (commonly known as the Revenue Act of 1918), duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV.

In his said tax return taxpayer claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

March 1st, 1913, fair value,		$120,000.00
Depreciation sustained	$ 3,000.00	
Selling Price	70,000.00	
		73,000.00
Loss		$ 47,000.00

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214, (a), 5, of the said Revenue Act of 1918, which reads:

> "That in computing net income there shall be allowed as deductions:—
>
> * * * * * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

V.

The facts with reference to the said transaction are that in the years 1887-1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, Jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish, however, the United States Revenue Field Agent who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established by A. & S. Wilson Company, one of the oldest firms of contractors in Pittsburgh. They show a cost appraisal of the residence as of the date of construction in the aggregate amount of $119,458.00. Similarly, with respect to the stable, they show the reproductive cost as of the date of construction to be $10,226.00.

About the year 1901, the Senator having been elected to the United States Senate, he leased the entire property to Mr. W. E. Corey, former President of the United States Steel Corporation, for a period

of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having a duration of ten years and providing for an annual rental of sixty-five hundred ($6,500.00) dollars. This lease was followed by a third lease dated April 1st, 1915, having a duration of one year for a stated annual rental of six thousand ($6,000.00) dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

As a part of the transaction Hammett was required to turn over to the Senator the equivalent of $9,500.00 advance rental collected by him on a garage property, which garage property represented part consideration in the transaction. The Field Agent held that such sum constituted additional income to the Senator and made adjustment accordingly (page 3 of his report).

The Field Agent made a computation of his own

of the consideration received by the Senator, taking into consideration accrued taxes, interest, etc., and arrived at the amount of $64,206.79 (page 3 of his report). For the purpose of this suit, it is admitted that the consideration as found by the Field Agent is correct, provided that there be added thereto the $9,500.00 hereabove mentioned.

VI.

Thereafter, as the result of the examination of plaintiffs' tax liability by the said United States Field Agent J. B. Harmon, plaintiffs were advised of a proposal to assess an alleged additional tax in the sum of $19,659.73. The said Field Agent, as pretended justification for the imposition of the proposed additional tax, asserted that taxable income shall be increased $56,500.00. In his official report, of which plaintiffs have been given a copy, he makes the following explanation—

> "In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:—
>
> | | | |
> |---|---|---|
> | Disallowance of loss on sale of former residence | $47,000.00 | |
> | Rent for the year 1921 received in 1920 | 9,500.00 | |
> | | | 56,500.00 |
> | Corrected Net Income | | $94,156.92" |

VII.

Thereafter, under date of September 27th, 1924, symbols IT:PA-5, CTN-505, the Commissioner of Internal Revenue advised plaintiffs that the conclusions of the Field Agent had been confirmed and that there was due from plaintiffs a pretended deficiency in tax of the aforesaid sum of $19,659.73.

VIII.

Thereafter, on or about January 23rd, 1925, the defendant, as Collector of United States Internal Revenue, demanded payment of the said sum of $19,659.73 alleged additional income tax from plaintiffs. Said amount was paid by plaintiffs to defendant on February 2nd, 1925, and such payment was made under protest and under duress, such duress consisting of threats by said defendant Heiner to impose penalties, levy distraint and seize plaintiffs' property.

IX.

Thereafter, on June 1st, 1925, plaintiffs duly filed with the defendant as Collector of Internal Revenue for the Twenty-third Pennsylvania District at Pittsburgh, on Form 843, the form prescribed by the Treasury Department, a claim for refund of the said amount of $19,659.73. A copy of said claim is attached hereto, designated Exhibit "A". There is imprinted thereon these words, as follows—

"Important.—File with the Collector of Internal Revenue where assessment was made."

X.

The said claim for refund was rejected by the Commissioner of Internal Revenue on August 20th, 1925, for the alleged reason that the loss claimed arose in a transaction not entered into for profit. At the time of filing this complaint, the said sum of $19,659.73 has not been refunded nor has any part thereof.

XI.

Plaintiff avers that there existed no warrant in fact or in law for the disallowance and exclusion by the aforesaid taxing authorities of said $47,000.00 loss suffered on the sale of said property as a deduction in the computation of taxable income, upon the alleged theory that loss arose from a transaction not entered into for profit,—

(2), nor for the imposition and collection of $19,659.73 alleged additional tax as a consequence thereof—

(3), nor for assuming that the selling price of the property was less than its cost; when, as a matter of truth and fact, the cost of the property was not less than $172,401.00—

(4), nor for assuming that the fair market value of the property at March 1st, 1913, was not in excess of $65,000.00; when, as a matter of truth and fact, the fair market value of the property at said date was not less than $125,000.00—

(5), nor for assuming that $9,500.00 received by taxpayer was taxable income because taxpayer's grantee had collected a like amount as advance rental

when, as a matter of truth and fact, such sum was part of the consideration received for the sale.

XII.

Plaintiffs further aver that the amount of loss correctly and properly deductible in the computation of the tax liability is—

Fair market value of property at March 1st, 1913		$125,000.00
Consideration received:—		
As computed by Field Agent	$64,206.79	
Additional consideration	9,500.00	
		73,706.79
Deductible Loss		$ 51,293.21

XIII.

When the true and correct amount of the deductible loss from the aforesaid sale, to wit, the said sum of $51,293.21, is employed, the amount of tax properly refundable is shown to be $20,356.85, all of which is set forth in the following computation:—

Taxable income employed by Field Agent and adopted by Commissioner		$94,156.92
Amount of loss deductible	$51,293.21	
Amount erroneously added to income as rent	9,500.00	
		60,793.21
Correct taxable income		$33,363.71

Tax previously paid:		
Paragraph III, *supra*	$ 2,991.68	
Paragraph VIII, *supra*	19,659.73	
		$22,651.41
Tax on $33,363.71		2,394.56
Amount refundable		$20,356.85

XIV.

Under sections 1019 and 1020 of the Revenue Act of 1924, plaintiffs may be allowed interest at the rate of six per centum per annum on the said sum of $20,356.85, from the date of payment thereof, to wit, from February 2nd, 1925.

XV.

This is a suit of a civil nature at common law and the matter in controversy, exclusive of interest, exceeds the sum of $3,000.00. The cause of action herein set forth arises under the laws of the United States for the assessment and collection of internal revenue.

WHEREFORE, plaintiffs pray judgment of the defendant in the sum of Twenty thousand, three hundred fifty-six and 85/100 ($20,356.85) dollars with interest, together with the costs of this suit.

JAMES WALTON,
Attorney for Plaintiffs.

Commonwealth of Pennsylvania,
County of Allegheny. } ss:

I, Charles E. Young, being first duly sworn, depose and say that I am Assistant Trust Officer of The Union Trust Company of Pittsburgh, co-executor of the Estate of Philander C. Knox, and that the allegations in the foregoing statement of claim are true and correct, as I verily believe.

CHARLES E. YOUNG.

Subscribed and sworn to before me this 22nd day of January, A. D. 1926.

LILLIAN D. MCCULLOUGH,

[SEAL] *Notary Public for Pennsylvania.*

My commission expires Feb. 26, 1927.

James R. Tindle et al. v D. B. Heiner, Collector.

EXHIBIT A—

Copy of Claim for Refund.

(Execute separate form for each tax period).

Claim for

Refund of Taxes Illegally Collected.

State of Pennsylvania,
County of Allegheny. } ss:

ESTATE OF PHILANDER C. KNOX, Deceased

c/o Union Trust Company, Executor

Pittsburgh, Pa.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below

with reference to said statement are true and complete:

1. Business in which engaged. Individual.

2. Character of assessment or tax. 1920 Income.

3. Amount of assessment or stamps purchased (alleged additional) $19,659.73.

4. Reduction of Tax Liability requested (Income and Profits Tax). Not applicable.

5. Amount to be abated. Not applicable.

6. Amount to be refunded (or such greater amount as is legally refundable) $19,659.73.

7. Dates of payment (see Collector's receipts or indorsements of canceled checks). February 2nd, 1925.

8. District in which return (if any) was filed. 23rd Penna., Pittsburgh.

9. District in which unpaid assessment appears. Not applicable.

10. Amount of overpayment claimed as credit. Not applicable.

11. Unpaid assessment against which credit is asked; period from. Not applicable.

Deponent verily believes that this application should be allowed for the following reasons:

Taxpayer attaches hereto a full and complete statement of the reasons why refund in the above stated amount should be made. Such statement, together with the exhibits attached thereto are hereby referred

to and specifically made a part of this claim for refund.

Address of taxpayer's attorney:

JAMES WALTON,
Southern Building,
Washington, D. C.

THE UNION TRUST COMPANY OF PITTSBURGH

By (Signed) CHARLES E. YOUNG,
Co-Executor
Asst. Trust Officer.

Sworn to and subscribed before me this 1st day of June, 1925.

(Signed) JESSIE A. ROBERTSON,
Notary Public.

In the matter of PHILANDER C. KNOX, Deceased UNION TRUST COMPANY, Executor Pittsburgh, Penna. 1920 Income Tax	Taxpayer's statement of the reasons why refund must be made.

I.

A report of examination by Field Agent J. B. Harmon of the Pittsburgh Revenue office, a copy of which was delivered to the executor on January 21st, 1924, advises taxpayer of a proposal to assess him with an additional tax in the amount of $19,659.73. A copy of this field agent's report is attached hereto as Exhibit A and the essential part thereof with reference to this particular matter reads as follows:

"In view of the fact that the selling price

of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

Disallowance of loss on sale of former residence,	$47,000.00	
Rent for the year 1921 received in 1920	9,500.00	56,500.00
Corrected Net Income,		$94,156.92"

II.

Thereafter the Commissioner of Internal Revenue at Washington, D. C., under date of July 24th, 1924, symbols IT:PA:5 CTN-505, duly advised the taxpayer of a proposal to assess an alleged deficiency in tax amounting to $19,659.73. This letter was on the usual Form NP-1, and the essential part of it reads:

	"Additional Tax
1920	$19,659.73

Verification of the books of account and records of Philander C. Knox as shown by the supplemental report of the revenue agent dated March 29, 1924, has been approved.

You are advised that the action taken by the revenue agent in regard to the disallowance of the loss on the sale of his residence has been sustained."

III.

Thereafter, on or about January 23rd, 1925, the Collector of Internal Revenue at Pittsburgh, Pa., made due demand for the payment of the aforesaid sum of $19,659.73, which amount was paid by the executor of the deceased taxpayer on February 2nd, 1925, all of which appears from the collector's receipt, a copy of which reads:

RECEIPT FOR PAYMENT OF TAXES
ORIGINAL
Addl. Income Tax

Collector's Office 23rd District of Penna.
at Pittsburgh, Pa.
Date 2/2/25 CHECK Year 1920

NAME AND ADDRESS OF TAXPAYER
Philander C. Knox, Deceased
c/o Union Trust Co., Executor
Pittsburgh, Pa.

Amount $19,659.73
1924 Addl. Jan. 186 P

PAID
Feb. 2 1925
INT. REV. COL. OFFICE
23rd District, Pgh., Pa.

IV.

Taxpayer respectfully shows that the Field Agent erred, that the Commissioner's office erred in adopting the conclusions of the Field Agent and that the action of the Collector of Internal Revenue at Pittsburgh, in insisting upon the payment of the alleged

additional tax was incorrect, not in accordance with the facts and contrary to law, in the following particulars:

(1), in assuming that the selling price of the property was less than its cost; whereas, as a matter of truth and fact, the cost of the property, the loss upon the sale of which is proposed to be disallowed, was not less than $124,206.79.

(2), in assuming that the market price of the property at March 1st, 1913, was not in excess of $65,000.00; whereas, as a matter of truth and fact, the market value of the property at said date was not less than $120,000.00.

(3), in presuming to add and include as taxable income an amount of $9,500.00 paid to the taxpayer by the purchaser of the property, which $9,500.00 represented advance rent collected by said purchaser on property which he traded to the taxpayer as part consideration for the taxpayer's property. As a matter of fact and law, this $9,500.00 was income of the taxpayer's grantee when received by him and is not, in any sense, taxable income to your petitioner; notwithstanding all of which, the Field Agent has so computed it and his computation has been tentatively approved by the office of the Commissioner of Internal Revenue.

It thus appearing that the Field Agent's proposed increase of taxable income is erroneous, it necessarily follows that the alleged additional income tax required to be paid thereon was not lawfully due and that the amount thereof should be refunded.

EXHIBIT A.

Copy of Field Agent's report
Dated January 18, 1924.

In the matter of
Philander C. Knox, Deceased,
Union Trust Company, Executor,
Pittsburgh, Penna.
1920 Income Tax

* * * * * * * *

"Note: If conference is desired, please arrange for an appointment. Mail to 802 Chamber of Commerce Bldg. Phone Smithfield 2438.

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

OFFICE OF
INTERNAL REVENUE AGENT
IN CHARGE
Pittsburgh Division.

January 18, 1924.

In re: P. C. Knox,
c/o Union Trust Company—Executor,
Pittsburgh, Pa.
Date of Report: January 11, 1924.
Year Examined: 1920.

Sirs:

There is transmitted herewith copy of report covering examination recently made by a representative of this office concerning your income tax liability.

No remittance should be made until you receive notice of assessment from the Collector of Internal Revenue for your district.

It is desired that every opportunity be afforded you to present any objections or any additional information which you believe might affect the result of the final decision of the Commissioner of Internal Revenue at Washington, D. C. The original of this report will therefore be held in this office for a period not to exceed twenty days from the date of this letter in order that you may, if you so desire, present any protests, briefs, or letters should be forwarded in duplicate to this office. These papers will receive consideration before the report with all papers pertaining to the same is transmitted to Washington for final action by the Commissioner of Internal Revenue. If you agree to the findings of the examining officer, the report will be forwarded to the Department at once.

Please acknowledge receipt by return mail, indicating whether protest will be submitted.

Respectfully,

ALBERT W. SMITH,
Internal Revenue Agent in Charge.

In re: P. C. Knox,
c/o Union Trust Company, Executor,
Pittsburgh, Pa.

January 11, 1924.

Examining Officer	Examination Commenced	Examination Completed
J. B. Harmon.	December 20—Suspended	January 11—7½ days

Internal Revenue Agent in Charge,
Pittsburgh, Pa.

An investigation of records in connection with

the income tax liability of the above named individual for the calendar year 1920 discloses the following:

Summary

Year	Form	Additional Tax
1920	1040	$19,659.73

Authority for Examination—Photostat copy of 1920 return, which is attached hereto.

Lack of records in this district prevented a thorough examination, although it is extremely doubtful that sufficient records could be assembled for such an examination of this case.

Your examiner has delved into all the available records in this city and has made quite a thorough examination of the sale of taxpayer's former residence reported in his 1920 return.

Marital Exemption—Married, living with wife.

Wife's Income—Separate return, with no claim for exemption.

The valuation placed by the City of Pittsburgh on the former residence property of the taxpayer for the year 1913 and subsequent years, including the year 1920, was as follows:

Land	$ 72,630.00
2 story stone brick dwelling	40,000.00
Frame stable	3,000.00
Total	$115,630.00

Your examiner finds upon investigation that the land included in the above cost the taxpayer $16,400.00 in three lots bought in 1886, 1887 and 1892. The cost

to the taxpayer for the erection of the buildings was probably $50,000.00 or more.

The real estate agent who sold the taxpayer's former residence property stated that the price at which it was sold, $65,000.00, was the market value of the property at March 1, 1913, and that a greater price could not be obtained for it at that date. The distribution of value at March 1, 1913, would probably be land, $40,000.00; dwelling, $24,000.00, and stable, $1,000.00.

In the sale of his property, the taxpayer took in payment a $90,000.00 property and assumed a mortgage of $40,000.00 on same, leaving him an equity of $50,000.00, which is confirmed by $50.00 of Revenue Stamps on deed received, and in addition, he received $15,000.00 cash. The former owner of the $90,000.00 property had received $9,500.00 in advance for rent of the large garage building on his property for the year 1921. This rent he had to turn over to the taxpayer at the time of closing the sale in November of 1920. The taxpayer apparently thought he had included this advance rent in the reported selling price of his property at $70,000.00, but investigation of the records of the real estate agent who sold the property for him discloses the fact that he received the following in settlement for the sale:

Equity in new property	$50,000.00
Cash	15,000.00
Accrued Interest on $40,000.00 Mortgage from 6/12/20 to 11/15/20	1,020.00

Pro rata amount of 1920 city and county taxes on his former residence property	404.40	
		$66,424.40
Less pro rata amount of 1920 city and county taxes on property taken in payment	152.61	
Revenue Stamps on Deed given	65.00	
Commission for selling	2,000.00	
		2,217.61
Net Proceeds or Selling Price		$64,206.79

Depreciation from March 1, 1913 to Dec. 31, 1919, is as follows:

Brick Stone Dwelling—		
$24,000.00 at 2% equals	480.00	per yr.
Frame Stable—		
1,000.00 at 5% equals	50.00	per yr.
Total	530.00	per yr.

$530.00 per year for 6 5/6 yrs. equals $3,621.67.

In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:

Disallowance of loss on sale of former residence	47,000.00	
Rent for year 1921 received in 1920	9,500.00	
		56,500.00
Corrected Net Income		94,156.92
Dividends	66,544.00	
Personal Exemption	2,000.00	
		68,544.00
Amount subject to Normal Tax		25,612.92
Amount subject to Normal Tax of 4%		4,000.00
Amount subject to Normal Tax of 8%		21,612 92
Normal Tax at 4%	160.00	
Normal Tax at 8%	1,729.03	
Surtax per Schedule	20,762.18	
Total Tax	22,651.21	
Previously Assessed	2,991.48	
Additional Tax	19,659.73	

The Union Trust Co. of Pittsburgh, Pa., one of the executors of the now deceased taxpayer, has been advised of the findings of this examination and has protected it in a letter to be mailed in to this office.

(Signed) J. B. HARMON,
Internal Revenue Inspector.

To the within Defendant:

You are required to file an affidavit of defense to this statement of claim within 15 days from the service hereof.

JAMES WALTON,
Attorney for Plaintiffs,
Fulton Building,
Pittsburgh, Penna.

Affidavit of Defense.

Filed February 25, 1926.

State of Pennsylvania, }
County of Allegheny. } *ss:*

D. B. Heiner, being duly sworn according to law, declares and says that he is the defendant in the above entitled cause and that he has a just, true, complete and legal defense to the whole of plaintiff's claim of the character and nature as follows:

1. The averments of paragraph 1 of plaintiffs' statement of claim are admitted.

2. The averments of paragraph 2 of plaintiffs' statement of claim are admitted.

3. The averments of paragraph 3 of plaintiffs' statement of claim are admitted.

4. The averments of paragraph 4 of plaintiffs' statement of claim are admitted.

5. The averments of paragraph 5 of plaintiffs' statement of claim are admitted.

6. The averments of paragraph 6 of plaintiffs' statement of claim are admitted.

7. The averments of paragraph 7 of plaintiffs' statement of claim are admitted.

8. The averments of paragraph 8 of plaintiffs' statement of claim are admitted.

9. The averments of paragraph 9 of plaintiffs' statement of claim are admitted.

10. The averments of paragraph 10 of plaintiffs' statement of claim are admitted but in mitigation thereof the defendant avers that on or about January 25, 1926, the said claim for refund was allowed in the sum of $4,863.04 and that the plaintiff, the Union Trust Company of Pittsburgh, Executor, etc., was notified of such allowance by letter from C. R. Nash, Assistant to the Commissioner, dated January 25, 1926, of which a copy was sent to Mr. J. M. Cumming, Southern Building, Washington, D. C., of counsel for the plaintiffs and so expects to be able to prove at the trial of this case.

11. The averments of paragraph 11 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the Revenue Act of 1918 there was no deductible loss suffered on the sale of said property; (2) that the said law justified the imposition and collection of the tax of $19,659.73, less the overassessment of $4,863.04, as above set out; (3) that there has been no assumption that the selling price of the property was not less than its cost; (4) that the fair market value of its property on March 1, 1913, in the claim for refund filed by the plaintiffs is stated at not less than $120,000, while in the complaint herein filed the same value of this property is stated at not less than $125,000; (5) that the contention of

the taxpayer in regard to the $9,500 has been conceded and this amount is the principal basis of the refund of $4,863.04 as above set out, all of which defendant expects to be able to prove at the trial of this case.

12. The averments of paragraph 12 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the Revenue Act of 1918 and regulations promulgated pursuant to law, no loss was suffered from the sale of this property, and so expects to be able to prove at the trial of this case.

13. The averments of paragraph 13 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the provisions of the Revenue Act of 1918 and regulations promulgated in pursuance to law, there was no deductible loss for income tax purposes from the sale of this property, and that the only sum refundable to the plaintiffs herein is the sum of $4,863.04, which was made the subject of Certificate of Overassessment No. 877468 and of which plaintiffs were advised on January 25, 1926, the said amount being arrived at as follows:

Tax assessed (original tax)	$ 2,991.68
Additional assessment, January 1925 list, page 13, line 6	19,659.73
Total assessment	$22,651.41
Tax liability	17,788.37
Overassessment	$ 4,863.04

and so expects to be able to prove at the trial of this case.

14. The averments of paragraph 14 of plaintiffs' statement of claim are denied insofar as it is alleged that interest may be allowed at the rate of 6% per annum on said sum of $20,356.85, and in answer thereto the defendant avers that the plaintiffs are entitled to interest at the rate of 6% per annum upon any amount recovered in this action, but that the amount so recovered, if any, cannot exceed the sum of $19,659.73, less $4,863.04 heretofore allowed plaintiff as above set out, that is, $14,796.69, and so expects to be able to prove at the trial of this case.

15. The averments of paragraph 15 of plaintiffs' statement of claim are admitted.

I, therefore, owe the plaintiff nothing.

All of the above stated facts are correct and true and defendant avers and expects on the trial of this case to be able to prove the same.

D. B. HEINER.

Subscribed and sworn to before me this 24th day of February, 1926.

GERTRUDE HORTON BERGER,

[SEAL] *Dep. Clerk U. S. Dist. Court.*

Opinion.

Filed Nov. 23, 1926.

THOMSON, J.:

This is an action brought by the executors of the will of Philander C. Knox, deceased, against the Collector of Internal Revenue of this District, to recover additional tax for the year 1920, the amount of which was assessed by the Government, and paid by the decedent under protest.

The facts in the case are briefly these: Senator Knox, decedent, built in about the year 1887 a residence in the city of Pittsburgh, at a cost of approximately $172,000.00. The building was occupied by Mr. Knox as his residence from the time it was built until 1901, when he was elected to the United States Senate. At that time the Senator moved his residence to the Schenley Hotel, Pittsburgh, from which residence he voted until the time of his death in 1921. From 1901 until 1920 he leased the property to various tenants, and in 1920 sold it to one James H. Hammett for the sum of $73,706.79.

The plaintiffs contend that the property was worth in the neighborhood of $120,000.00 on March 1, 1913, and claim as a loss, the difference between that sum and the amount for which it was sold in 1920, and seek to deduct that amount from the income of the taxpayer for the year 1920 under Section 214 (a) (5) of the Revenue Act of 1918. This particular section of the law reads as follows:

> "That is computing net income there shall be allowed as deductions:
>
> "5. Losses sustained during the taxable year

and not compensated for by insurance or otherwise, *if incurred in any transaction entered into for profit,* though not connected with the trade or business."

The defendant's contention is that the purchase of the property by a taxpayer for his residence is not a transaction entered into for profit under the Revenue Acts. He also contends that the property had the same value in 1913 that it had in 1920, at the time of its sale and that hence no deductible loss in any case was sustained by the taxpayer.

The evidence justifies the finding which I now make, that the fair value of the property as of March 1, 1913, was $120,000.00, and if the loss in the sale is a deductible loss under the section of the Revenue Act above recited, the difference between that value and the price at which the property sold, would represent that loss. We are, therefore, confronted with the question of the proper interpretation of the law in question under the facts as they are conceded to be. The provisions of section 5 are also contained in the Revenue Acts of 1921, 1924 and 1926. Regulations 45 as promulgated April 17, 1919, provided as follows:

"Art. 141. *Losses.* * * * A loss in the sale of an individual's residence is not deductible."

This regulation was amended on January 28, 1921, to read as follows:

"Art. 141. *Losses.* * * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

This same provision is contained in Regulations 62, under the Revenue Act of 1921, and in Regulations 65, under the Revenue Act of 1924.

The question is, is the purchase of property by a taxpayer for his residence a transaction entered into for profit; if not, where the taxpayer ceases to use the property as his residence and leases it to another as a residence, is the status changed, making the renting of the property a new transaction entered into for profit.

In the Solicitor's Law Opinion 780 (1 Cumulative Bulletin 117) it is said:

> "The expression 'transaction entered into for profit' clearly means a complete business venture from inception to conclusion. The deduction allowed is for losses sustained in any transaction *'entered into'* for profit. The intent to make a profit must have existed at the commencement of the enterprise or the right to deduct losses incurred is not within the contemplation of the statute. To construe the words 'transaction entered into for profit' as referring only to the conclusion of the venture—that is, the sale of the property—would result in a practical nullification of the statute. * * *
>
> "Where a loss incurred in the sale of residential property is deductible in arriving at net income must be determined by the object or intent of the individual in buying or constructing the property."

The provision of the law under which the plaintiff claims was not in any Revenue Act prior to 1918,

but has been in all the Revenue Acts from 1918 to and including the Act of 1926. Except in one appeal before the Board of Tax Appeals no case is reported in the Courts interpreting this provision. In the case of the appeal of John J. Madden, 2 U. S., Board of Tax Appeals, page 702, decided on September 30, 1925, the Board held that the building of a house to meet the taxpayer's requirements for a home was not a transaction entered into for profit. In office decision 1148 (5 Cumulative Bulletin, page 141) it is said:

> "It is held that if a loss is deductible at all it is deductible under section 214 (a) 5 of the Revenue Act of 1918 as a loss sustained in a transaction entered into for profit. However, the mere renting of property purchased without the intention at the time of purchase of making a pecuniary profit thereon does not constitute a 'transaction entered into for profit' within the meaning of the statute, and as the taxpayer in the instant case purchased the property for a home, it was not his intention at the time to subsequently sell it for profit. It is therefore held that any loss sustained is not deductible for the purposes of the Revenue Act of 1918."

Ever since the Act of 1918 was passed the Regulations have provided that a loss in the sale of property purchased by a taxpayer for his residence is not a loss in a transaction entered into for profit. The original Regulations 45 provided that a loss in the sale of an individual's residence is not deductible. The amendment of January 28, 1921, provided that a loss on

the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. The one is an amendment of the other and can scarcely be said to have effected any material change. Both relate to the beginning of the transaction, viz: the purchase or construction of the property in question.

The decisions of the department have been uniform and all have held the loss in such cases not a deductible loss. The reinactment of the law year after year without change must be taken as an indication not only to continue in force the existing law but to adopt the practice of the department in interpreting and applying it. It was said in *United States v. Anderson,* 46 Sup. Ct., 131:

> "By thus adopting without material change, the corresponding provisions of earlier acts, Congress might have been deemed to have recognized and adopted the established practice of the Department interpreting and applying them. *National Lead Co. v. United States,* 252 U. S., 140."

See also *Provost v. United States,* 46 Sup. Ct., 152.

The issuing of Regulations by the Secretary of the Treasury is subsequently made his duty by the Revenue Act of 1918, and other Revenue Acts, and the Supreme Court has held that it is settled by the decisions of that Court that a regulation by a department of Government, addressed to and reasonably adapted to the enforcement of an Act of Congress, the administration of which is confided to such depart-

ment, has the force and effect of law if it be not in conflict with express statutory provision. *United States v. Grimaud,* 220 U. S. 506, and many other cases.

It appears to me that the rulings of the department are in harmony with the provisions of the law. The transaction in question is one which began with the purchase and ended with the sale. The transaction was the ownership of the property and was ended when the property was sold. It cannot be fairly said that this was entered into for profit but was entered into for the purpose of providing a home for the taxpayer. The transaction which was begun by the leasing of the property ended when the lease was ended, and it is not suggested that this was a loss. This is true of each succeeding lease. The transaction which was ended by the sale of the property seems clearly to have been the one which was begun by its purchase.

I am, therefore, compelled to hold that the plaintiffs' position that the loss claimed by the decedent as a deduction from taxable income under section 214 (a) of the Revenue Act of 1918, cannot be sustained. It appears, however, that in June, 1925, the plaintiffs filed with the defendant as Collector of Internal Revenue, a claim for refund of the amount of taxes which had been paid under protest, which claim was denied except as to the amount of $4,863.04, which sum was allowed, but has not in fact been paid by the Government. The allowance of this claim is conceded by the defendant in the affidavit of defense filed.

Plaintiff is, therefore, entitled to judgment in this action in the sum of $4,863.04 with interest from the date of payment thereof, to wit, from February 2, 1925.

Judgment may, therefore, be entered accordingly.

Plaintiff's Request for Findings of Fact, Conclusions of Law and Order of Court.

Filed January 21, 1927.

Comes now the plaintiff, by James Walton, Esquire, its counsel, and, in accordance with Rule 38 of the United States Supreme Court as revised, Paragraph 2, adopted June 8, 1925, and effective July 1, 1925, considering itself aggrieved by the findings of fact and conclusions of law as made and handed down by the Honorable Court in the above-entitled cause on the 23rd day of November, 1926, and considering the facts hereafter set forth to have been proven and deeming them material to a hearing and determination of this cause upon a writ of error to the Circuit Court of Appeals and similarly so considering with respect to the conclusions of law hereafter set forth, does, therefore, respectfully request the Honorable Court to find as facts and as conclusions of law as follows:

FINDINGS OF FACT.

I.

Philander C. Knox died October 12th, 1921. At the time of his death he was a citizen of Pennsylvania

and a resident of Pittsburgh, Allegheny County, in the Western District of said state. His last will and testament was duly admitted to probate in the Orphans Court of Allegheny County, and on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff James R. Tindle is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said state, and the plaintiff The Union Trust Company of Pittsburgh is a Pennsylvania corporation with its principal office and place of business at Pittsburgh, Allegheny County, Pennyslvania. By its articles of incorporation, the Union Trust Company of Pittsburgh is authorized and empowered to act as executor, trustee and in other fiduciary capacities.

II.

The defendant D. B. Heiner is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the Western District of Pennsylvania. Said Heiner, at the time of the grievances set forth in and at the date of filing the statement of claim is Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, which district comprises within its borders the County of Allegheny.

III.

Within the time prescribed by law, the said Philander C. Knox, duly made and filed his income tax return for the calendar year 1920 on Form 1040, which

is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV.

In his said tax return Mr. Knox claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

March 1st, 1913, fair value		$120,000.00
Depreciation sustained	$ 3,000.00	
Selling Price	70,000.00	73,000.00
Loss		$ 47,000.00

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214, (a), 5, of the Revenue Act of 1918 which reads—

> "That in computing net income there shall be allowed as deductions:—
>
> * * * * * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

V.

The facts with reference to the said transaction are that in the years 1887-1888 former United States

Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, Jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish, however, the United States Revenue Field Agent who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established as of the date of construction, to be the sum of $119,458.00. Similarly with respect to the stable, the cost as of the date of construction is fixed at $10,226.00.

About the year 1901, the Senator having been elected to the United States Senate, leased the entire property to Mr. W. E. Corey, former President of the Unitd States Steel Corporation for a period of 3½ years, the lease being dated October 1st, 1901 and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having a duration of ten years and providing for an annual rental of sixty-five hundred ($6,500.00) dollars. This lease was followed by a third lease dated April 1st,

1915, having a duration of one year for a stated annual rental of six thousand ($6,000.00) dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

VI.

I find as a fact that the cost of the entire property was approximately $172,000.00.

VII.

I find as a fact that the March 1, 1913, fair market value of the entire property was $120,000.00.

VIII.

I find as a fact that the total consideration which Mr. Knox received for the entire property was $73,706.79.

IX.

The Commissioner of Internal Revenue, in auditing Senator Knox's tax return, made two changes or adjustments—

First he disallowed the $47,000.00 claimed loss on the sale of the property at 5044 Ellsworth Avenue, and

Second, he added $9,500.00 to income which he claimed was rental.

By this process $19,659.73 alleged additional tax was computed against the taxpayer, it was duly assessed, it was paid under protest, a claim for refund was filed and the claim for refund was rejected by the Commissioner of Internal Revenue on August 20, 1925. This suit was filed January 22, 1926.

X.

The plaintiff's contention with respect to the $9,500.00 item is conceded by the defendant and, subsequent to the date of the trial, a refund was made to the plaintiff to the extent such item was a factor in the alleged additional tax; to wit, $4,863.04.

CONCLUSIONS OF LAW.

I.

I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence, terminated what originally may have been a transaction entered into not for profit.

II.

I find, as a conclusion of law that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same, constituted a new transaction,—a transaction entered into for profit and that the loss suffered in the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income.

III.

I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913, fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21.

IV.

I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto.

V.

I find, as a conclusion of law, that plaintiff is entitled to a judgment against the defendant in the amount sued for as set forth in the statement of claim,

together with costs and statutory interest, subject however to adjustment and modification in the amount of $4,863.04 which has already been refunded to the plaintiff and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21.

Respectfully submitted,

JAMES WALTON,
Attorney for Plaintiff.

January 17, 1927.

Order of Court.

(a) ADOPTING PLAINTIFF'S REQUESTED FINDINGS OF FACT

(b) REJECING PLAINTIFF'S REQUESTED CONCLUSIONS OF LAW

And now, to wit, on this 21st day of January, 1927, this cause comes before the court upon the plaintiff's request for specific findings of fact and conclusions of law, and the court being fully advised in the premises and having heretofore, on November 23, 1926, handed down its opinion in the case, does therefore find and decline to find as follows:—

Each and every one of plaintiff's requested findings of facts, numbered I to X inclusive, are approved and adopted in their entirety, the same being not inconsistent with the court's opinion heretofore filed:

Each and every one of plaintiff's requested conclusions of law, numbered I to V inclusive, are disap-

proved and rejected in their entirety, the same being contrary to the court's opinion heretofore filed.

W. H. S. THOMSON,
Judge.

Eo die, plaintiff objects to the above action of the court in rejecting his requested conclusions of law and at his instance exception noted.

W. H. S. THOMSON.

Order.

Filed Jan. 21, 1927.

And now, to wit, January 21, 1927, it appearing by stipulation of counsel herewith filed, that the sum of $4,863.04, the amount conceded to be due plaintiff in the affidavit of defense, was paid by the defendant to the plaintiff prior to the previous entry of judgment herein; by virtue of this fact and under said stipulation, it is hereby ordered and adjudged that the said judgment be, and the same is hereby vacated and set aside. Thereupon counsel for plaintiff presents to the Court certain requests for findings of fact and conclusions of law, which requests I have answered and file the same herewith, as if answered and filed with the original opinion; and now, the day and year aforesaid, judgment is hereby entered in favor of the defendant with costs.

W. H. S. THOMSON,
Judge.

Assignments of Error.

Filed Jan. 25, 1927.

The plaintiff in this action, in connection with his petition for a writ of error, makes the following assignments of error which he avers occurred upon trial of the cause, to wit:

I.

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered I, as follows:

> "I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence, terminated what originally may have been a transaction entered into not for profit."

II.

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered II, as follows:

> "I find, as a conclusion of law that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same, constituted a new transaction,—a transaction entered into for profit and that the loss suffered on the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income."

III.

The court erred in declining to make and rejecting plaintiffs requsted conclusion of law numbered III, as follows:

"I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913 fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21."

IV.

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numberd IV, as follows:

"I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto."

V.

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered V, as follows:

"I find, as a conclusion of law, that plaintiff is entitled to a judgment against the defendant

in the amount sued for as set forth in the statement of claim, together with costs and statutory interest, subject however to adjustment and modification in the amount of $4,863.04 which has already been refunded to the plaintiff and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21."

WHEREFORE the plaintiff prays that the judgment of the District Court may be reversed.

JAMES WALTON,
Attorney for Plaintiff.

Pittsburgh, Penna.
January 25, 1927.

Stipulation for Printing Record.

And now, to wit, January 24th, 1927, it is hereby stipulated and agreed by and between counsel for plaintiff and counsel for the defendant that the following be printed as and constitute the record on writ of error in the above case before the United States Circuit Court of Appeals for the Third Circuit, viz.:

1. Docket entries.

2. Statement of Claim.

3. Affidavit of defense.

4. Request for findings of fact and conclusions of law *ex parte* plaintiff.

5. Opinion of the court filed November 23, 1926.

6. Supplemental opinion of the court filed January 21, 1927, together with order of judgment in favor of the defendant which is a part thereof.

7. Assignments of error.

8. This stipulation.

JAMES WALTON,
Attorney for Plaintiff.

W. J. AIKEN,
Asst. U. S. Attorney,
Attorney for Defendant.

Certificate.

Western District of Pennsylvania, ss:

I, J. Wood Clark, Clerk of the District Court of the United States for the Western District of Pennsylvania, do hereby certify that the annexed and foregoing pages contain a true and correct copy of the record sur writ of error in the above entitled case, so full and entire as the same remains of record and on file in my office, in the City of Pittsburgh, in said District.

IN TESTIMONY WHEREOF, I have hereunto signed my name and affixed the seal of the said Court, at Pittsburgh, this 1st day of February, A. D. 1927.

J. WOOD CLARK,
Clerk.

In the United States Circuit Court of Appeals for the Third Circuit

MARCH TERM, 1927

No. 3594 (List No. 3)

J. R. TINDLE ET AL., EXECUTORS P. C. KNOX, DECEASED, PLAINTIFFS IN ERROR

v.

D. B. HEINER, COLLECTOR, DEFENDANT IN ERROR

And afterwards, to wit, on the 8th day of March, 1927, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Joseph Buffington, Honorable Victor B. Woolley, and Honorable J. Warren Davis, circuit judges, and the court, not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 4th day of April, 1927, come the parties aforesaid by their counsel aforesaid, and the court, now being fully advised in the premises, renders the following decision: James R. Tindle and the Union Trust Company of Pittsburgh, co-executors of the last will and testament of Philander C. Knox, deceased, plaintiffs below, plaintiffs in error, *v.* D. B. Heiner, Collector of Internal Revenue, defendant below, defendant in error.

In Error to the District Court of the United States for the Western District of Pennsylvania

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges

BUFFINGTON, *Circuit Judge:*

This case centers around the word "transaction"—"transaction entered into for profit"—as used in the revenue act of 1918 (40 Stat. c. 18, section 214, a 5), in respect to losses allowed as deductions in income-tax returns. What, in point of fact, is the transaction we are here dealing with? Was it one Congress meant to cover by this section? Viewed as an entirety, the transaction involved is this: In 1887–1888 the late Philander C. Knox bought ground in the city of Pittsburgh and built a residence thereon at a cost, in all, of $172,000. In 1920 he sold this property and residence for $73,706.79, so that, taken as a whole, the transaction begun in 1887 and ended in 1920 constitutes a single whole from the viewpoint of buying and selling; but when this single whole is considered from the standpoint of the use to which the property had, meanwhile, been put

it resolves itself into two distinct and wholly different transactions. First, the property was used by him as a residence; he built the house for that purpose and so used it until 1901. This transaction was therefore a distinctively home, residential one. In 1901, however, he entered into national public life and gave up the property as a residence, and never afterwards occupied it. He acquired a residence by living in a different ward of the city and retained it up to the time of his death for occasional residential and seasonal voting purposes, and, as stated by counsel at the hearing, his regular winter residence was in Washington City, where he bought and occupied a home, and his summer residence in a home he owned at Valley Forge, Pennsylvania.

With the ending of his occupation of his Pittsburgh home he rented the same on long-term leases. His first lease was in October, 1901, for three and a half years; later for a term of ten years and thereafter for shorter terms, until the property was finally sold. With the giving up of his residence all sentimental connection in the use of the house as a home ended and thereafter the use of the property was by others under lease from him during the running of the first lease for three years, to wit, from October 1, 1901, and then from April 1, 1905, for ten years. During the running of these leases he was of course unable to sell the property by reason of the use he was making of it and the leases he had given for his own profit. Such being the status of the transaction, the ordinary one of owning real estate for leasing purposes, the situation of the property under the second or ten-year lease when the income tax law of 1913 was passed, was a distinctively nonresidential and a distinctively business leasing of real estate for profit. We think we are justified in regarding the transaction here involved by its then and subsequent status. The situation was in no wise different than it would have been had he always owned and used the property for renting purposes and never for residential purposes, because the residential use had finally and forever ceased at the time of the passage of the income tax law. What, then, was the fact and status in money value of this property when the income tax law of 1913 was passed? It was a distinctively renting transaction and in this transaction was involved the use for renting of property of the agreed upon then value of $120,000. Any system of bookkeeping in this transaction would have had charged against it an investment of $120,000 represented by real estate, and the rents upon the same would have been profits. What, then, would have been the result of this transaction when it was finally closed? Clearly instead of profits a loss represented by the shrinkage in value of the property during that time of $46,293.21.

But, assuming the situation was one where some might contend, as did the court below, that the language of Congress was intended to treat the transaction as a purchase and sale of property without reference to what its use was during the interim, it seems to us the opposite view might very reasonably be taken of holding Mr. Knox's tenure as made up of two transactions, one, the residential one, which had ceased to exist long before and to which the law did not apply, the other, a purely business venture, unfortunate in its results, but one which the law fairly contemplated should be offset against other

items of income which the owner of the property sustained. It seems to us therefore with this double interpretation in the balance that the law would then resolve that uncertainty against the Government in favor of the taxpayer. Assured as we are that this latter transaction was one entered into and carried on for profit, the decedent, in the assessment of his net income, should have been allowed credit for the loss resulting therefrom.

The judgment below will therefore be reversed with instructions to enter judgment for the taxpayer's estate.

(Indorsements:) 3594. Opinion of the court by Buffington, J. Received and filed April 4, 1927. Saunders Lewis, jr., clerk.

J. R. Tindle et al., executors; Philander C. Knox, deceased, plaintiffs in error, *v.* D. B. Heiner, collector, defendant in error

In error to the District Court of the United States for the Western District of Pennsylvania

This cause came on to be heard on the transcript of record from the District Court of the United States for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, reversed, with instructions to the said district court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

Per curiam:

BUFFINGTON,
Circuit Judge.

(Indorsements:) 3594. Order reversing judgment received and filed April 4, 1927. Saunders Lewis, jr., clerk.

The President of the United States of America, to the honorable the judges of the District Court of the United States for the Western District of Pennsylvania, greeting:

Whereas lately in the District Court of the United States for the Western District of Pennsylvania, before you or some of you, in a cause between James R. Tindle and the Union Trust Company of Pittsburgh, coexecutors of the last will and testament of Philander C. Knox, deceased (plaintiffs below), plaintiffs in error, and D. B. Heiner, collector of United States internal revenue for the 23d district of Pennsylvania (defendant below), defendant in error, a judgment was entered in the said district court on the twenty-first day of January, 1927, which judgment is of record in the office of the clerk of the said district court, to which reference is hereby made, and the same is hereby expressly made a part hereof, as by the inspection of the transcript of the record of the said district court, which was brought into the United States Circuit Court of Appeals for the Third Circuit by virtue of a writ of error agreeably to the act of Congress, in such case made and provided, more fully and at large appears.

And whereas, in the present term of March, in the year of our Lord one thousand nine hundred and twenty-seven, the said cause came on to be heard before the said United States Circuit Court of Appeals on the said transcript of record and was argued by counsel:

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, reversed, with instructions, to the said district court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

You, therefore, are hereby commanded that such execution and further proceeding be had in said cause, as according to right and justice, and the laws of the United States, ought to be had, the said writ of error notwithstanding.

Witness, the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the ninth day of May, in the year of our Lord one thousand nine hundred and twenty-seven (1927).

SAUNDERS LEWIS, Jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

Original file No. 3594. U. S. Circuit Court of Appeals, third circuit. No. 3, March term, 1927. J. R. Tindle et al., executors, P. C. Knox, deceased, plaintiffs in error, *v.* D. B. Heiner, collector, defendant in error. Copy of mandate. Received and filed May 9, 1927. Saunders Lewis, jr., clerk.

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, third judicial circuit, sct:

I, Saunders Lewis, jr., clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original record and proceedings in this court in the case of James R. Tindle et al., plaintiffs in error, *v.* D. B. Heiner, collector, defendant in error, No. 3594, on file, and now remaining among the records of the said court, in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court at Philadelphia this 21st day of June, in the year of our Lord one thousand nine hundred and twenty-seven, and of the independence of the United States the one hundred and fifty-first.

[SEAL.] SAUNDERS LEWIS, Jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1927

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In the Supreme Court of the United States

OCTOBER TERM, 1927

No. ——

D. B. HEINER, COLLECTOR OF UNITED STATES Internal Revenue for the Twenty-third District of Pennsylvania, petitioner

v.

JAMES R. TINDLE AND THE UNION TRUST COMPANY of Pittsburgh, Coexecutors of the Last Will and Testament of Philander C. Knox

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on April 4, 1927 (R. 50), reversing the judgment of the District Court of the United States for the Western District of Pennsylvania (R. 43).

STATEMENT

The question presented is whether a loss incurred in a sale of residential property is deductible in computing a taxpayer's net income under the provisions of Section 214 (a) (5) of the Revenue Act of 1918.

In 1887 Philander C. Knox, the taxpayer, now deceased, built a residence in Pittsburgh at a cost of $172,000. The building was occupied by him as his residence until 1901, at which time he moved to the Schenley Hotel, Pittsburgh, where he resided until his death in 1921. From 1901 until 1920 the residence was leased to various tenants. There is no evidence as to the value of the property in 1901. In 1920 it was sold for $73,706.79. On March 1, 1913, the property was worth $120,000. In computing his 1920 income for income-tax purposes the taxpayer claimed as a loss the difference between the value of the residence on March 1, 1913, and its sale price in 1920. (R. 35–40.)

The petitioner contends that the purchase of the property by the taxpayer for his residence in 1887 was not a transaction entered into for profit under Sectiton 214 (a) (5) of the Revenue Act of 1918, and that the leasing of such residence property in 1901 did not initiate a new transaction under the statute.

The District Court for the Western District of Pennsylvania decided the case in favor of this petitioner. (17 F. (2d) 522.) The judgment of the Dis-

trict Court was reversed by the Circuit Court of Appeals for the Third Circuit. (18 F. (2d) 452.) The Circuit Court of Appeals entered judgment on April 4, 1927, and it is to review this judgment of the Circuit Court of Appeals that the writ of certiorari is now sought.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals, Third Circuit, erred:

I. In reversing the judgment of the District Court of the United States for the Western District of Pennsylvania.

II. In holding that the transaction which resulted in a loss by the sale of the taxpayer's property was entered into for profit.

III. In holding that the transaction which resulted in a loss by the sale of the property was entered into by the leasing of the property.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals has misconstrued Section 214 (a) (5) of the Revenue Act of 1918 in holding that a loss sustained upon the sale of a residence property is deductible in computing taxable income.

2. The decision of the Circuit Court of Appeals is contrary to the decision of this Court in *McCaughn* v. *Ludington* (268 U. S. 106), in which it was held that a deductible loss must be measured by the difference between the selling price and the cost or the March 1, 1913, value, whichever is lower.

3. A proper construction of Section 214 (a) (5) of the Revenue Act of 1918 is fundamental in auditing many thousands of income-tax returns because said section was intended by Congress to fix the dividing line between business transactions entered into for profit and personal transactions.

4. The decision of the Circuit Court of Appeals changes the long-established and accepted practice of the Treasury Department and the basis generally adopted by taxpayers in filing returns.

5. The decision of the Circuit Court of Appeals is contrary to the rulings of the United States Board of Tax Appeals.

Wherefore, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

JUNE, 1927.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the District Court (R. 29) is reported in 17 F. (2d) 522. The opinion of the Circuit Court of Appeals (R. 48) is reported in 18 F. (2d) 452.

JURISDICTION

The judgment of the Circuit Court of Appeals sought to be reversed was entered April 4, 1927. (R. 50.) Jurisdiction to issue the writ is found in

the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question presented is whether Section 214 (a) (5) of the Revenue Act of 1918, providing a deduction in computing net income for losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business, contemplates a deduction for loss resulting from the sale of residential property purchased, erected, and used as a residence for the taxpayer, and which is later, before sale, leased and occupied by tenants.

THE STATUTE

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1066, provides as follows:

> SEC. 214 (a). That in computing net income there shall be allowed as deductions * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

Regulations 45, as promulgated April 17, 1919, provide as follows:

> ART. 141. *Losses.*—* * * A loss in the sale of an individual's residence is not deductible.

This was amended on January 28, 1921, and thereafter reads as follows:

> ART. 141. *Losses.*—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

This provision is also contained, unchanged, in Regulations 62 under the Revenue Act of 1921, Regulations 65 under the Revenue Act of 1924, and Regulations 69 under the Revenue Act of 1926.

STATEMENT

The facts are sufficiently stated in the petition for certiorari.

ARGUMENT

The Circuit Court of Appeals concedes that the acquisition of the property by the taxpayer for a residence in 1887 was not a transaction entered into for profit. The gist of its decision is that since the property was leased to others for use as a residence from 1901 until the sale thereof in 1920 a new transaction commenced, which was entered into for profit.

In this case the property cost $172,000 in 1887. It is undisputed that the property was worth $120,000 on March 1, 1913, and that it was sold in 1920 for $73,706.79. The loss resulting from the sale of the property, under the decision of this Court in *McCaughn* v. *Ludington* (268 U. S. 106), if deductible, would be the difference between the

the selling price and the cost or March 1, 1913, value, whichever is lower. In determining the amount of such loss in this and in all other cases the original cost is a factor. There is nothing in the law to warrant the use of the value as of the date when a property, acquired and used as a private residence, is leased to others for residential purposes. Furthermore, in this case there is no evidence of the value of the property as of the date when it was leased in 1901.

The loss which the taxpayer sought to deduct is the loss which occurred when the property was sold for less than it cost. Manifestly, the "transaction" which was *ended* by the *sale* must have been *begun* by the *purchase* of the same property, since the purchase price is a factor in determining loss or gain. It necessarily follows that the "transaction" resulting in the loss was "entered into" by the purchase. That transaction concededly not having been entered into for profit, it follows as of course that no loss resulting from that transaction is deductible.

The Circuit Court of Appeals held that the leasing of the residence in 1901 was the beginning of a new transaction. To be consistent, the cost of acquisition at an earlier date could not be used as a basis for determining gain or loss, because on date of acquisition and for years afterwards the property was intended and used for personal residence of the owner. No cost or value as of 1901,

when abandoned as the owner's residence, is disclosed by the record, and without it the rule in the case of *McCaughn* v. *Ludington, supra,* can not be applied.

If the leasing of the property was a new transaction, that transaction was not ended by the sale of the property. The taxpayer sold the residence, not the lease; hence it follows that the leasing transaction was not ended by the sale nor was it the transaction out of which the loss occurred. If the execution of the lease was the beginning of the transaction, then that transaction could only end by the expiration of the lease or by the sale thereof. Hence a deductible loss could flow only from that transaction. The purchase and sale of the real estate is entirely disconnected from such a loss.

A proper construction of Section 214 (a) (5) of the Revenue Act of 1918 is extremely important to the Government and to taxpayers generally. That provision has been reenacted by Congress without change in the three succeeding Revenue Acts of 1921, 1924, and 1926. The Regulations of the Treasury Department have consistently interpreted the law as contended for by the petitioner in this case. The United States Board of Tax Appeals has followed the Department's interpretation of the law in similar cases. (*Appeal of John J. Madden,* 2 B. T. A. 702; *Appeal of Alice Grace D'Oench,* 3 B. T. A. 24.)

This particular section of the law embodies the dividing line between losses resulting from business

transactions entered into for profit and purely personal transactions. Unless the provision in the statute that gain or loss may be considered only if in transactions *entered into* for profit be literally applied the greatest confusion results. The decision of the Circuit Court of Appeals introduces an element of confusion and uncertainty as to what is meant by a transaction entered into for profit. If the decision of the Circuit Court of Appeals is allowed to stand unreversed, a large amount of litigation will result and large sums of money will be required to be refunded. In view of this and of the need for a definite rule for the guidance of the courts and the Treasury Department in such cases, it is respectfully submitted that the petition for certiorari should be granted in this case.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.
F. S. TOOMEY,
Special Attorney,
Bureau of Internal Revenue.

JUNE, 1927.

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In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 341

D. B. HEINER, COLLECTOR OF UNITED STATES INTERNAL REVENUE for the Twenty-third District of Pennsylvania, Petitioner

v.

JAMES R. TINDLE AND THE UNION TRUST COMPANY of Pittsburgh, Coexecutors of the Last Will and Testament of Philander C. Knox

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 15) is reported in 17 F. (2d) 522. The opinion of the Circuit Court of Appeals (R. 26) is reported in 18 F. (2d) 452.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 4, 1927. (R. 28.) Petition for

certiorari was filed June 30, 1927, and granted October 24, 1927 (R. 29), under the provisions of Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

THE QUESTIONS PRESENTED

The case presents first the question whether Section 214 (a) (5) of the Revenue Act of 1918, providing that in computing net income for income-tax purposes there shall be allowed as deductions losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business, contemplates a deduction for a loss resulting from the sale of property acquired for and used as a residence by the taxpayer, but which later, before its sale, was leased and occupied by tenants.

If the above question be answered in the affirmative, the case presents the further question whether the basis for the purpose of ascertaining the loss sustained from the sale of the property is its original cost, its value on the date when the taxpayer ceased to use it as a residence and leased it to tenants, or, in the case of property acquired before March 1, 1913, its value on that date.

THE STATUTE AND REGULATIONS

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1066–1067, 1069, provides as follows:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sus-

tained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

* * * * *

Sec. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

Sec. 215. That in computing net income no deduction shall in any case be allowed in respect of—

(a) Personal, living, or family expenses;

* * * * *

Regulations 45, as promulgated April 17, 1919, provide as follows:

Art. 141. *Losses.*—* * * A loss in the sale of an individual's residence is not deductible.

This was amended on January 28, 1921, and thereafter reads as follows:

> ART. 141. *Losses.*—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

This provision is also contained, unchanged, in Regulations 62 under the Revenue Act of 1921, Regulations 65 under the Revenue Act of 1924, and Regulations 69 under the Revenue Act of 1926.

STATEMENT

Findings of fact requested by the respondents (R. 19–21) were approved and adopted in their entirety by the District Court, although that court disapproved and rejected the respondent's requested conclusions of law and rendered judgment in favor of the petititoner (R. 23). The facts are therefore undisputed.

In the years 1887–1888 Philander C. Knox, the taxpayer, now deceased, built a residence in Pittsburgh. A short time later he built a stable. The land was acquired in three transactions, in 1886, 1887, and 1892, respectively. (R. 20.) The cost of the entire property was approximately $172,000. (R. 21.) The necessary inference from the findings is that it was his family residence until 1901, when, having been elected United States Senator, Mr. Knox leased the property for three and one-half years and other leases to various tenants followed

until 1920, when the property was sold for $73,706.79. (R. 20–21.) At no time after the leasing of the property in 1901 was it occupied by Mr. Knox or by his family or relatives, and he forthwith established an actual and legal residence at a place elsewhere in Pittsburgh. (R. 21.) The fair market value of the property on March 1, 1913, was $120,000. (R. 21.) There is no finding and no evidence as to the value of the property in 1901, when the first lease was made.

In his income-tax return for the year 1920 the taxpayer claimed as a deduction from income, as a loss suffered in the sale of the property in question, the difference between the March 1, 1913, value of the property less depreciation and the selling price of the property. (R. 19–20.) The Commissioner of Internal Revenue disallowed the deduction, an additional tax was assessed and paid under protest, and a claim for refund was filed and rejected. (R. 21.) The taxpayer's executors then brought this suit to recover the amount of the additional tax so assessed and paid. After the suit was brought the respondent's contention as to a second item in dispute was conceded by the petitioner and refund was made, so that item is no longer involved in the case. (R. 21.)

The District Court for the Western District of Pennsylvania decided the case in favor of the present petitioner. (R. 23.) The judgment of the District Court was reversed by the Circuit Court of Appeals for the Third Circuit. (R. 28.)

SPECIFICATION OF ERRORS TO BE URGED

The petitioner contends that the Circuit Court of Appeals, Third Circuit, erred—

I. In reversing the judgment of the District Court of the United States for the Western District of Pennsylvania.

II. In holding that the transaction which resulted in a loss by the sale of the taxpayer's property was entered into for profit.

III. In holding that the transaction which resulted in a loss by the sale of the property was entered into by the leasing of the property.

SUMMARY OF ARGUMENT

The acquisition of the property in question by the taxpayer for his residence in 1887 was not a transaction entered into for profit within the meaning of Section 214(a)(5) of the Revenue Act of 1918. It does not appear that the acquisition of the property was to save rent, and in any event a saving of rent would not be profit, and the saving would be of a family or living expense not itself deductible.

It is doubtful whether the leasing of the property in 1901 made the subsequent ownership thereof a new transaction entered into for profit within the meaning of the statute. It would seem that the transaction terminated by the sale of the property must have been entered into by its purchase, regardless of what different uses were made of it in the meantime.

The practical difficulties which would be involved in treating each change in the use of property as a new transaction for the purpose of determining gain or loss may well have led Congress to adopt this rule. That Congress intended to make the character of the transaction at the date of acquisition of property determinative of whether a loss resulting from its sale is or is not deductible is indicated (1) by the fact that under Section 202 of the Revenue Act of 1918, as construed by this Court in *United States* v. *Flannery,* 268 U. S. 98, and *McCaughn* v. *Ludington,* 268 U. S. 106, cost is always a factor in determining the gain or loss resulting from a sale of property, and the Act provides no formula using value at the time of any change in the use of property in place of cost, and (2) by the fact that the regulations of the Treasury Department since January 28, 1921, have taken the view that the question whether or not a transaction is entered into for profit is to be determined upon the basis of intention at the time of the acquisition of property, without regard to subsequent change in its use, and the fact that Congress has re-enacted Section 214(a)(5) without change in the Revenue Acts of 1921, 1924, and 1926, thus indicating its approval of the Treasury Department's interpretation.

There is nothing in the Revenue Act of 1918 to justify making the character of the use of the property on March 1, 1913, determinative of whether or not the loss incurred upon its sale was deduct-

ible. The transaction resulting in the loss was entered into either in 1887, when the property was acquired, or in 1901, when it was first leased.

Even if it be assumed that the transaction terminated by the sale of the property was one entered into for profit within the meaning of Section 214 (a) (5) of the Revenue Act of 1918, and that any loss sustained as a result of such transaction was a proper deduction in computing net income, the only logical basis for determining gain or loss is the value in 1901, when the residential use ceased and the leasing began, and as this does not appear in the case there is no showing that any loss was sustained.

ARGUMENT

I

THE ACQUISITION OF THE PROPERTY IN QUESTION BY THE TAXPAYER FOR HIS RESIDENCE IN 1887 WAS NOT A TRANSACTION ENTERED INTO FOR PROFIT WITHIN THE MEANING OF SECTION 214 (A) (5) OF THE REVENUE ACT OF 1918

The Circuit Court of Appeals concedes that the acquisition of the property by the taxpayer for a residence in 1887 was not a transaction entered into for profit, but "a distinctively home, residential, one." The suggestion was made in respondents' brief in opposition that the acquisition of a residence is a transaction for profit if entered into to save rent or transportation charges; that profit means net profit and arises just as much from cut-

ting down expenses as it does from increasing gross income.

The short answer to this is that the rent of a dwelling saved by owning one is a personal living or family expense, which, under Section 215 of the Revenue Act of 1918, is not allowed as a deduction, and if the expense saved is not deductible the cost of saving it is not. Besides, there was no finding that the acquisition of this dwelling, costing $172,000, was to save expenses.

The mere fact that a building is used as a residence does not necessarily mean that it was not acquired for profit. Recognition of this fact probably led to the amendment of Article 141 of Regulations 45, which originally prohibited deduction of "a loss in the sale of an individual's residence" and as amended prohibited deduction only of "a loss in the sale of residential property * * * unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

The Board of Tax Appeals in a series of cases has held that decision of the question whether or not a residence was acquired for profit depends upon whether, on all of the facts, it appears that the predominating factor leading to its acquisition was the prospect of future profit, or the intention to use it as a home. (*Appeal of Robert W. Williams*, 1 B. T. A. 1101; *Appeal of Helen Converse Thorpe*, 3 B. T. A. 1006; *Appeal of Henry DeFord*, 7 B. T. A. 630; *Appeal of Sidney W. Sinsheimer*,

7 B. T. A. 1099; *Appeal of John N. Hughes,* 8 B. T. A. 206.) Certainly in the present case it can not be seriously contended that the prospect of future profit was the predominating factor leading to the acquisition of the property in question in 1887.

II

IT IS DOUBTFUL WHETHER THE LEASING OF THE PROPERTY IN 1901 MADE THE SUBSEQUENT OWNERSHIP THEREOF A NEW TRANSACTION ENTERED INTO FOR PROFIT WITHIN THE MEANING OF THE STATUTE

The real question in the case is whether the leasing of the property in 1901 made its subsequent ownership a new transaction entered into for profit within the meaning of the Revenue Act of 1918. The District Judge held that the leasing had no such effect, saying (R. 18):

> The transaction in question is one which began with the purchase and ended with the sale. The transaction was the ownership of the property and was ended when the property was sold. It can not be fairly said that this was entered into for profit but was entered into for the purpose of providing a home for the taxpayer. The transaction which was begun by the leasing of the property ended when the lease was ended, and it is not suggested that this was a loss. This is true of each succeeding lease. The transaction which was ended by the sale of the property seems clearly to have been the one which was begun by its purchase.

The Circuit Court of Appeals, while apparently basing its conclusion primarily on other grounds discussed in Point III of this brief, nevertheless indicated that it thought the ownership of the property in question should be divided into two transactions, a residential one, which ceased in 1901, and a business venture, which commenced in that year.

The question, of course, is what Congress intended. It may be admitted that Congress might logically have provided that losses resulting from retention of property for business purposes should be deductible although the property was originally acquired as a residence, but it is doubtful whether the Revenue Act of 1918 can be so construed. Giving the language used its ordinary meaning, it would seem that, as the District Judge held, the transaction terminated by the sale of the property must have been entered into by its purchase, regardless of what different uses were made of it in the meantime. Nor can such a rule be said to be unreasonable.

It is worthy of note that the Act of 1913 (c. 16, 38 Stat. 114, 167) merely allowed as deductions losses "actually sustained during the year, incurred in trade," and losses arising from certain casualties, while Section 5 (a) Fifth of the Revenue Act of 1916 (c. 463, 39 Stat. 756, 759) allowed the deduction of losses sustained in transactions entered into for profit but not connected with business or trade only to the extent of profits arising from

similar transactions. The practical difficulties which would be involved in treating each change in the use of property as a new transaction for the purpose of determining gain or loss, including determination of when the use has actually changed and fixing of market value at varying dates, may well have led Congress to make the character of the transaction at the date of acquisition of property determinative of whether a loss resulting from its sale is or is not deductible, regardless of changes in use and fluctuations in value during the period of ownership.

That this was the intention of Congress is indicated by the fact that Section 202 of the Revenue Act of 1918, providing for the determination of gain or loss, does not seem to be appropriate if a change in the use of property be regarded as a new transaction. That section provides that for the purpose of ascertaining the gain derived or loss sustained from the sale of property, the basis shall be—

> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; * * *

In *United States* v. *Flannery,* 268 U. S. 98, and *McCaughn* v. *Ludington,* 268 U. S. 106, this Court held that the Act of 1918 allows a deduction to the extent only that an actual loss is sustained from an investment, as measured by the difference between

the purchase and sales prices of the property. In the *Flannery case* it was said (page 103):

> * * * we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an actual gain was derived or an actual loss sustained from the investment, and that the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.

It results that cost is always a factor in the determination of gain or loss from the sale of property, even though the property was acquired before March 1, 1913. In the present case no cost is properly available. The cost of the property in 1887 for residential purposes manifestly can not be used as the cost of the alleged new transaction entered into for profit in 1901. If the ownership of the property after 1901 was a new transaction for the purpose of deciding whether it was entered into for profit, it must also have been a new transaction for the purpose of determining its cost. And there was no cost in 1901. Where value is to be used in place of actual cost or selling price, the Revenue Act so provides, as in Section 202 (b) relating to exchanges of property. The Act contains nothing to warrant the determination of gain or loss on the basis of value as of the date when property, acquired and used as a private residence,

is leased to others. Moreover, in the present case there is no finding or evidence as to the value of the property in question in 1901.

The Treasury Department has consistently taken the view that the question whether or not a transaction is entered into for profit is to be determined upon the basis of intention at the time of the acquisition of property without regard to subsequent changes in its use. Whatever ambiguity there may have been in Article 141 of Regulations 45 as originally promulgated, this is clearly the effect of the amended provision adopted on January 28, 1921, and contained without change in regulations under subsequent Revenue Acts that:

> Art. 141. *Losses.*—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

This view has been set forth in a number of Treasury Department opinions and memoranda. 1 Cumulative Bulletin (Dec., 1919) 117; 5 Cumulative Bulletin (Dec., 1921) 141; Cumulative Bulletin II–1 (June, 1923) 95; Cumulative Bulletin II–2 (Dec., 1923) 119.

As pointed out by the District Judge, the reenactment of Section 214 (a)(5) without change in the Revenue Acts of 1921, 1924, and 1926 is some indication that Congress intended to approve and adopt the interpretation placed upon it by the Treasury Department. *United States* v. *Anderson,* 269 U. S.

422, 439; *Provost* v. *United States,* 269 U. S. 443, 458.

Until the decision of the Circuit Court of Appeals in the present case was rendered the United States Board of Tax Appeals followed the Treasury Department's interpretation of the law. *Appeal of John J. Madden,* 2 B. T. A. 702; *Appeal of Alice Grace D'Oench,* 3 B. T. A. 24; *Appeal of Fred L. Mandel,* 4 B. T. A. 1001. In *Appeal of Walter J. Ball,* 8 B. T. A. 180, the Board of Tax Appeals followed the decision of the Circuit Court of Appeals in the present case.

III

THERE IS NOTHING IN THE STATUTE TO JUSTIFY MAKING THE CHARACTER OF THE USE OF THE PROPERTY ON MARCH 1, 1913, DETERMINATIVE OF WHETHER OR NOT THE LOSS INCURRED UPON ITS SALE WAS DEDUCTIBLE

The opinion of the Circuit Court of Appeals (R. 26–27) appears to be based primarily on the theory that—

> * * * the situation of the property * * * when the income tax law of 1913 was passed, was a distinctively nonresidential and a distinctively business leasing of real estate for profit. We think we are justified in regarding the transaction here involved by its then and subsequent status.

From this the Circuit Court of Appeals apparently concluded that there was a deductible loss measured by the difference between the March 1,

1913, value and the selling price. But it seems clear that no new transaction was entered into on March 1, 1913. The transaction resulting in the loss was entered into either in 1887, when the property was acquired, or in 1901, when it was first leased, and we are unable to see any possible justification under the statute for making the situation on March 1, 1913, determinative of whether or not the loss is deductible.

Moreover, the conclusion of the Circuit Court of Appeals seems clearly inconsistent with *United States* v. *Flannery* and *McCaughn* v. *Ludington, supra.* Those cases held that March 1, 1913, value is not the basis for ascertaining gain or loss resulting from the sale of property, even in the case of property acquired before that date; that actual gain or loss is contemplated by the statute and the provision with respect to March 1, 1913, value is merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.

It follows logically that the date on which the transaction was actually entered into, and not March 1, 1913, which is merely the date upon which the 1913 income tax law became effective, must be looked to in order to determine whether the transaction was entered into for profit.

IV

IF THE TRANSACTION TERMINATED BY THE SALE OF THE PROPERTY IN QUESTION WAS ONE ENTERED INTO FOR PROFIT, THE ONLY LOGICAL BASIS FOR DETERMINING GAIN OR LOSS IS THE VALUE IN 1901, WHEN THE RESIDENTIAL USE CEASED AND THE LEASING BEGAN, AND AS THIS DOES NOT APPEAR IN THE CASE THERE IS NO SHOWING THAT ANY LOSS WAS SUSTAINED

If it be assumed that the transaction terminated by the sale of the property in question in this case was one entered into for profit within the meaning of Section 214 (a) (5) of the Revenue Act of 1918, and that any loss sustained as a result of such transaction was a proper deduction in computing net income, the respondents are faced with the further difficulty that there is nothing in the case to show that any loss was sustained.

As we have pointed out before, it would be wholly illogical to take the cost at the time the property was acquired in 1887 as the basis for ascertaining gain or loss and at the same time give no effect to the fact that the acquisition was not for profit. If the transaction terminated by the sale was the one entered into in 1887, there was a loss, but it is not deductible because the transaction was not entered into for profit.

To take the March 1, 1913, value as the basis for ascertaining gain or loss would be clearly inconsistent with the decisions of this Court in *United States* v. *Flannery* and *McCaughn* v. *Ludington, supra.*

The only remaining basis for ascertaining gain or loss is the value in 1901, when the property ceased to be used as a residence and was leased to persons other than the taxpayer. This would at least be a logical basis for ascertaining the gain or loss resulting from the retention of the property as an investment, although, as stated above, we think it doubtful whether the statute contemplates the use of such a basis. But in any event, there is absolutely nothing in the case to show the value of the property in 1901. Consequently, if such value is the proper basis for ascertaining gain or loss, the respondents have failed to show that any loss was sustained.

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

WILLIAM D. MITCHELL,
Solicitor General.
GARDNER P. LLOYD,
Special Assistant to the Attorney General.

FEBRUARY, 1928.

○

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

NO. 341

D. B. HEINER, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania,
Petitioner,

v.

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, Co-Executors of the Last Will and Testament of Philander C. Knox.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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Brief in Opposition to Petition for Writ of Certiorari.

There is involved in this case the correct interpretation of section 214 (a) (5) of the Revenue Act of 1918, c. 18, 40 Stat. L. 1057-1066, which reads—

> SEC. 214 (a). That in computing net income there shall be allowed as deductions * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

The facts are fairly stated in the petitioner's statement, pages 2 and 3.

The orginal interpretation of the statute by the Bureau of Internal Revenue, in effect at the time when Senator Knox sold his property, reads as follows:

> ART. 141. Losses. * * *. A loss in the sale of an individual's residence is not deductible.
> *Reg.* 45, *promulgated Apr.* 17, 1919.

This interpretation is clear, definite, certain and capable of being uniformly administered.

Senator Knox sold the property with respect to which this controversy arises, in the year 1920. On January 28, 1921, the Bureau of Internal Revenue changed its interpretation of the law and promulgated the following official regulation—

> ART. 141. Losses.—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

The view point of the Bureau of Internal Revenue is further amplified by an official publication which, among other things, reads as follows—

> If, on the other hand, the property is occupied by the purchaser as his home during the whole or a great portion of the period of his ownership, a strong presumption is raised that the property was purchased for his personal use as a residence; that the transaction was not "entered into for profit" within the meaning of the statute. This presumption will not be overcome by his self-serving declaration, uncorroborated, that his purpose was otherwise.
> 0-780
> 1 *Cumulative Bulletin,* 117.

First, it will be observed in the amended interpretation of the Bureau that the profit must be "pecuniary." The statute does not say so, and this certainly seems to be

an attempt to extend the meaning of the act by implication,—contrary to the rule of this court laid down in *Gould v. Gould,* 245 U. S. 151.

If Mr. and Mrs. John Newlewed, living in a rented apartment, conclude they can save money by buying a home of their own on the installment plan, how can it be said that that is not a transaction for profit. Or, John Smith, living in Baltimore, in a house which cost him $10,000.00, takes employment in Washington, and finds himself obliged to spend a $1.50 a day for transportation, besides the waste of time in getting back and forth to his work; he therefore, trades his residence in Baltimore, at an estimated sacrifice of $1,000.00, for a residence in Washington. He figures that, although he has lost a thousand dollars in the trade, he has more than made up for it by the saving in transportation cost and the saving in time. Obviously, this is a transaction for profit, yet the Bureau of Internal Revenue says not. As a practical proposition, "profit" means net profit and arises just as much from cutting down expenses as it does from increasing gross income.

Second, by the amended interpretation of the Bureau the "pecuniary profit" must be contemplated to arise from a subsequent sale of the property. Here again is an interpretation entirely by implication. It means that if a man were to buy a house with the purpose and intent of deriving an income from the rental of the property, he would not be engaged in a transaction for profit. The Bureau now says it is not sufficient that the profit shall come from the rental of the property, notwithstanding the fact that the taxpayer never occupied the property as a residence, and bought it solely for the purpose of deriving an income from such rental. To say that a man is not engaged in a transaction for profit when he buys a residence property for the purpose of obtaining as income the rental thereof,

is simply absurd. What his intent may be after he gets through renting the property is wholly immaterial. Very likely, he may not have a fixed intent with respect to the disposal of the property at the time he buys it. The possibility of a satisfactory sale would be in his mind perhaps, or he might have it in mind to leave the property to his wife and children.

Thirdly, the Bureau says, (quoted *supra*), the taxpayer cannot prove his intent by his self-serving declaration, uncorroborated, that his purpose was otherwise (than a transaction not for profit). If the intent of the taxpayer has to be proven as of the year 1888, as the Bureau here contends, and the taxpayer is dead, how is the intent to be proven? How can anyone testify to what was in Senator Knox's mind in 1888? We all know that he was a far-sighted, thrifty man, and that he must have taken into consideration the possibility of the eventual sale of his property on Ellsworth Avenue when he bought the land and built his residence on it in the year 1888. The Bureau's interpretation of the meaning of the statute results in absurdities. Samuel Smart knows the interpretation and regulations of the Bureau, and when he builds his residence he puts a "For Sale" sign on it for a month or two, and has a photograph taken of the residence with the "For Sale" sign on it. As a further precaution, he goes to his friendly real estate broker and lists the property for sale. Honest John Brown, being uninformed in the matter, builds his residence right alongside of Samuel Smart and, although his intent and purpose is exactly the same, he fails to put up a "For Sale" sign and doesn't list the property with his real estate broker. The result is that Smart is able to meet the Bureau's test of "intent," while poor Brown will be held to have engaged in a transaction not for profit.

The next question that arises under the Bureau's pro-

posed interpretation is what must a man do to terminate a transaction "not for profit." If instead of renting his former residence in the year 1901, with some few alterations in the structure of the building, the Senator had transformed the building into an apartment hotel, would he still be engaged in a transaction not for profit? Or if he had built an office building upon the property, what then would the status have been? The Bureau of Internal Revenue apparently concedes that the disposal of an estate in fee simple will terminate a transaction "not for profit." What then will be the effect of the disposal of an estate for 99 years or the disposal of a life estate, or an estate for a lesser period of time? In this case, the Senator disposed of an estate for ten years by a lease to W. E. Corey and followed that with other leasings. If that is not sufficient to terminate a transaction "not for profit," would a lease for thirty years have done it? Where is the line of distinction?

Brief Discussion of Petitioner's Argument.

On page 2, the petitioner points out that there is no evidence in this case of the value of the property as of the date when it was leased in the year 1901. The petitioner apparently considers that this is important because he again reiterates the same statement on page 7. But in interpreting the statute, this court has said in *McCaughn v. Ludington,* 268 U. S. 106, that the loss resulting from the sale of property is the difference between the selling price and the cost or March 1, 1913 value, whichever is lower. It is admitted that the cost was $172,000.00 and the March 1, 1913 fair value was $120,000.00. How can the value in the year 1901 have any possible bearing on the case? Incidentally, it may be pointed out that if we could utilize the value as of 1901, it would be to our advantage.

On page 7 the petitioner asserts that the transaction which was ended by the sale must have begun by the purchase of the same property. If a man buys a grocery store and at the end of ten years retires from business, and rents the store to his son or someone else, is he still "entered into" the grocery business? If the law provided for a special exemption to any man who had entered the ministry, would that mean that it included any man who had ever entered the ministry at any time, regardless of the fact that he might be engaged in the bootlegging business as of the date when the taxing revenue act was enacted? At this point it may be stated that Senator Knox concluded that it was a status of the property as of the date when the Revenue Act was passed, which was determinative of whether it represented a transaction "for profit" or not for profit.

On page 8 of petitioner's brief it is asserted—

"The taxpayer sold the residence, not the lease, hence it follows that the leasing transaction was not ended

by the sale nor was it the transaction out of which the loss occurred."

How could a lessor sell a lease on his own property? What happened was that the taxpayer first disposed of an estate for years through a lease and followed it with other leases. He then disposed of an estate in fee simple. Moreover, it can well be said that the loss did arise from the lease. If the Senator had sold in 1901 when he abandoned or relinquished the property as his residence, there might not have been any loss, or at least, a loss in a much lesser amount. From the time the property was leased for rental purposes, it decreased in value steadily. Therefore, it can be said with full justification that it was the leasing of the property that was the proximate cause of the loss. The sale of the fee simple simply brought the loss into being—into reality.

The point is, however, not what was the proximate cause of the loss, but what kind of a transaction was the taxpayer entered into or engaged in when he suffered the loss. The purpose of this particular section of the revenue act was to prevent men of great wealth from escaping income tax by employing as deductions the losses which they suffered by operating pleasure yachts, racing stables, private golf courses, model dairy farms and such other fads and fancies, which are to them not transactions for profit. But Congress said that if you are entered into or engaged in something which produces income, which produces profit, and you are required to include such profit in your income tax return, as was the case with Senator Knox, then if you suffer a loss as a result of being entered into such a profit producing or income producing transaction, you may employ such loss as a deduction in your income tax return. Anything less than that would be injustice. How can it be said that a man is not entered into a transaction for profit when he does get profit by

way of rental and, moreover, is required to list such profit in his income tax return and pay income tax upon it? To first require a taxpayer to pay tax upon the profit which he derives from a transaction and then, when he puts the transaction at an end, to say that he has not been engaged in a transaction for profit and may not employ the loss which he suffers thereby, would be utterly unfair and is not lightly to be attributed to Congress.

On page 8 of petitioner's brief it is asserted—

> "The regulations of the Treasury Department have consistently interpreted the law as contended for by the petitioner in this case."

The original interpretation of the Department in Article 141, Regulations 45, and the subsequent interpretation as amended on January 28, 1921, have been quoted *supra*. Also compare Office Decision 138, 1 Cumulative Bulletin 124, published in 1919, and also consider what was said in Order 780, 1 Cumulative Bulletin, 117, published in 1919—

> "Few, if any, transactions are 'entered into' other than for profit of some kind * * *. If the residential property be held by the purchaser out of use or under tenancy and be subsequently sold, there would seem little room for question that the transaction was 'entered into for profit' and that the loss, if any, is a proper deduction in determining net income."

What has happened in this case is that the Bureau has altered and changed its interpretation of the statute, and is seeking to apply the change in interpretation *ex post facto*, to include Senator Knox's case.

Respectfully submitted,

JAMES WALTON,
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July 30, 1927.

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July 30, 1927.

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IN THE

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v.

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, Coexecutors of the Last Will and Testament of Philander C. Knox.

BRIEF FOR RESPONDENTS.

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BRIEF FOR RESPONDENTS.

The facts, statutes involved and questions presented are set forth accurately in petitioner's brief.

I.

Summary of Argument.

1. The purchase or building of a house for residential purposes is a transaction for profit.

2. In any event, where a taxpayer built a house for residential purposes in 1887-8, and in 1901 permanently abandoned it as a residence and thereafter, continuously and uninterruptedly held it for rental purposes, he thereby entered into a second transaction which was a transaction entered into for profit.

3. Excess of return over expenditure in a given transaction or series of transactions."

It also gives the following synonyms: Benefit, avail, service, improvement, advancement, gain, emolument.

"Profit" is variously defined as "any advantage, any acquisition of good, from labor or exertion."

32 Cyc. 585.

The above definitions should settle the question in favor of the right of the taxpayer to the credit, for how can it be doubted that a man, when he builds or buys a home, is doing so because of the advantages, benefits, valuable results, useful consequences, that he expects to flow from it?

But the petitioner contends that in spite of the fact that a taxpayer entered into the transaction for profit in the senses above expressed, he cannot deduct a loss thereon, unless he embarked on the venture also with the intent to obtain an excess of return over expenditure, or, in other words, to sell it for more than it cost him. Of course, it cannot be disputed that that idea will also qualify under the term "profit," but has the Government the right to pick out that one meaning, out of all the meanings that lexicographers and Courts give to the word, and say that that is the only one, which, if present in the mind of the taxpayer at the time of the acquisition, will entitle him to take credit for the loss?

Arguendo, we will concede the soundness, from a legal standpoint, of the proposition that a tax may be valid in spite of the fact that it is unfair and unjust according to the ordinary concepts of these terms, but no such construction should be placed upon a statute unless there is no escape from it, that is, unless it is so clear and unmis-

takable that there is no possible way out. If there is a doubt,—a substantial doubt,—if it is possible to draw a different meaning, which is more fair and equitable, that meaning should be drawn.

Quite aside from the facts that, (a), the benefit which Senator Knox undoubtedly expected to get when he built this house is a "profit" within the meaning given to that word by standard dictionaries, and Courts, and that, (b), if there should be some doubt about it, it should be resolved in favor of the taxpayer (who would have to pay a tax on the gain, if he made any), we have the powerful, if indirect, light thrown on this matter by the deduction allowed by the very next sub-division of this section of the Act, viz:

> "(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise."

This shows that Congress realized that a man's profit for a given year was fictitious, if we are to count only the gains he made in business, *et cetera,* and did not take into consideration the losses sustained by him on property owned by him which was not connected with his regular trade or business, *such as his dwelling house,* for instance.

Such an anomaly as that the taxpayer must report a profit on his dwelling, and may deduct a loss, if it is damaged by a casualty, but *may not* deduct a loss on a sale, cannot be imputed to Congress unless they said so in the most unmistakable language, and this they have not done.

It is absurd to suppose that Congress intended to give the taxpayer credit for a loss sustained on his dwelling house, if the loss resulted from fire, although its purchase was not, in the narrow sense of the term, a transaction entered into for profit, but not from the other cause, to wit: a sale. What reason would move Congress to permit the loss in the one case and not in the other?

> "A *narrow meaning of a word is rarely given a revenue statute,* and the adjudications uniformly hold that words of general description often embrace an unnamed article, or one that was not thought of by the enacting power at the time the act was passed."
>
> *American La France Co. v. Riordan,* 294 Fed. 567 (D. C. W. D. of N. Y. Nov. 7, 1923)

> "A statute should be so construed as to avoid unjust consequences; unless the language compels such a result, and construction should be given with reference both to the history of the legislation and to other section of the law *in pari materia.*"
>
> *Bankers Trust Co. et al. v. Bowers,* Collector, 295 Fed. 89 (C. C. A. 2nd Circuit)

Courts, in construing the exempting clauses of taxing statutes, are not required to hunt for an escape from an exemption, but will, where the intent to exempt clearly appears, give effect to such intent without evasion. The rule as to strict constructions will not be deviated from where it results favorably to the taxpayer.

> *Buchanan v. Knoxville & Ohio R. R. Co.,* 71 Fed. 324, 333, 6th C. C. A., 1895, before Taft, C. J. and Hammond and Severens, J. cited by Holmes Federal Taxes, 6th Ed. p. 1588, sec. 971, (Geo. E. Holmes, Esq., of the Advisory Tax Committee)

But, we submit, this general rule should not affect this case, in any event, for the reason that we are dealing with an income tax, a tax, not on gross, but on the net result obtained by subtracting certain credits from certain debits, items of expense and losses, from gains and profits. Both charges and credits are equally part of the warp and woof of this plan of taxation. Here a net figure is to be taxed, and there is no reason why the general rule of liberal construction should not be applied throughout. This is assuming that there is a doubt, from the language of the statute, whether the loss sustained by the taxpayer in the sale of his residence is deductible. We deny this, and contend that there is no doubt in view of, (1) the language of the act authorizing the deduction, (2) the fact that the profit on the sale of the house, if there had been a profit, would have to be included in the income; and, (3) the plainly allowable deductions under subdivision (6) of the same section of the act for loss of every other nature, character and description that might be sustained on the same house.

The learned Solicitor General assumes that the acquisition of a house for residential purposes is necessarily not a transaction for profit and bases his conclusion on the theory that since the savings in rent and other savings are family or living expenses, and are thus not permitted as deductions in making up an income tax return, therefore "that doesn't count". But the statute uses the word "profit" without restriction,—unqualifiedly. It doesn't read "profit as it is defined by this Act upon which the tax shall be computed." The effect of the Treasury Department's position is to make the statute read "transactions entered into *primarily* for *pecuniary* profit." The word "profit" as used in the statute means profit as it is ordinarily understood in every day transactions of business. To illustrate, the interest on municipal bonds is tax free,—does not have

to be included in statutory taxable income. But certainly a man who buys $100,000.00 of tax-free municipal bonds has none the less entered into a transaction for profit.

No less an authority than that high priest of thrift, Benjamin Franklin tells us that the purchase of a home is a most profitable transaction. Moreover, there isn't a question but what Senator Knox, a man of thrift and foresight, took into full account and consideration the ultimate sale possibilities of his property. No man, knowing the value of a dollar, ever bought or built a home with his eyes shut to the possibility or necessity of sale at some time in the future.

(c).

IF THE PURCHASE OF A RESIDENCE IS NOT A TRANSACTION ENTERED INTO FOR PROFIT.

Let us assume, for the purpose of immediate argument, that the Senator did build a house without any thought of pecuniary profit, that he had a definite and immutable intent to occupy it as a residence until he died, and under no conditions had there entered his mind any thought of selling the property if he might be able to effect such a sale advantageously at a profit. For the purpose of this case we can admit all of this as of the years 1887 and 1888 when he built the house, and as continuing until the year 1901. But in 1901, the original transaction terminated. He and his family moved out of the house. He first leased it for a period of three and a half years, then for a period of ten years, then made other leases running down to the year 1920, when the property was sold. Certainly the leasing of the property was a transaction—there can't be any question but what it comes within the definition of what constitutes a transaction; moreover, it is ridiculous to say that it was not a transac-

tion entered into for profit, when profit actually inured therefrom. He derived profit from the transaction in the way of rentals; furthermore, such rentals had to be included in his tax return and income tax paid thereon. A transaction from which profit is derived certainly can not be anything else than a "transaction entered into for profit."

The United States Board of Tax Appeals has held that a transaction may be entered into for profit at any time, and not solely at the inception of an undertaking. *Thomas F. Sheridan v. Commissioner of Internal Revenue,* 4. B. T. A. 1299.

The Circuit Court of Appeals for the Second Circuit, in *Wilson v. Eisner,* 282 Fed. 38, held that an enterprise may be one entered into as a business for profit as well as one entered into for pleasure.

(d).

THE REASONABLE AND LOGICAL INTERPRETATION OF THE STATUTE.

For a better understanding, let us take, by way of analogy, the case of a man who goes to the bank and withdraws $1,000.00 for the purpose of making a pleasure trip to Europe. That, of course, is not a transaction entered into for profit. Before his departure he is solicited to buy some stock in the Hokum Land Company, which turns out to be worthless and he loses his entire $1,000.00. Is he precluded from taking a loss in his tax return because in the beginning it was a "transaction not for profit"? Certainly not, because it is obvious that there were two transactions. He first entered into a transaction "not for profit", but that terminated, and he then entered into a second transaction which was "for profit".

Or assume that the Revenue Act granted some particular exemption to all persons who had entered into the ministry. A certain taxpayer, claiming to be within this exemption, is able to prove that he did enter into the ministry in the year 1889. But subsequent thereto, in the year 1901, he abandoned the ministry and entered into a life of crime or some other activity and such was his admitted status as of the date of the passage of the Revenue Act. Could he, by any possible stretch of imagination, be considered as coming within the exemption? It is too plain for argument that his status as of the date of the passage of the Revenue Act would be looked to and be decisive as to whether or not he is entitled to the exemption.

By way of further analogy, let us assume that two men, Smith and Jones, are each the owners of seven-passenger Studebaker automobiles. Let us assume that the automobiles were purchased not for profit. Having heard the glowing tales of opportunity in Florida, these two men drive their cars from Pittsburgh to Florida. On arrival, they find that Florida is not as roseate as painted and, having limited means, they both go "broke". Smith and Jones, accordingly, drive their cars back to Pittsburgh and, being in need of immediate income, they take their cars and go into the automobile livery business, the carrying of passengers by automobile for hire. Under the Commissioner's interpretation of the statute, the two men would still be engaged in a transaction "not for profit" because the automobiles had originally been bought for pleasure purposes. If, however, they would simply go through the perfunctory motion of trading machines with each other, then, according to the Commissioner, they would be held to be engaged in a transaction "for profit". After this trade, what had before been the pleasure automobile of the one would become the "business" automobile of the other, despite the fact that the two machines were absolutely identical in make, character and description. The

interpretation of a statute which leads to such incongruities and absurdities as this surely will not find favor in the eyes of any court.

> "In the matter of taxation, there should be a rigid adherence to facts. It is from fiction that the evils of double taxation arise. The present tendency of our Supreme Court is to adhere to the facts, and this appears in the decision of the Supreme Court in *Hostetter's Estate,* 267 Pa. 193-196."
>
> *Commonwealth v. Presbyterian Hospital,* 287 Pa. 49.

(e).

WHAT IS REQUIRED TO PUT AN END TO A TRANSACTION "NOT FOR PROFIT"?

Certainly it will be conceded that if a man disposes of his residence through a sale in fee simple that puts an end to the transaction "not for profit". If he disposes of it through the conveyance of his life estate, that, too, I think the learned counsel for the Commissioner will concede, terminates the transaction "not for profit". If he leases the former residential property for 99 years, surely it must be admitted that puts an end to his transactions "not for profit". What if he leases for 50 years, or 25 or 10? Just where is the line of demarcation which we can put our finger on and say the conveyance of an estate to this extent terminates a transaction not for profit, but the conveyance of this lesser estates leaves the transaction "not for profit", still going on—still in existence. Senator Knox leased it to Corey for 10 years. If that lease is not of sufficient length of time to end the transaction "not for profit", would 30 years have done it? Where is the line of distinction? By this simple illustration we expose at once the whole fallacy of the petitioner's contention. If

instead of renting his former residence in the year 1901, with some few alterations in the structure of the building, Senator Knox had transformed the building into an apartment hotel, would he still be engaged in a transaction not for profit? Or if he had built an office building upon the property, what would the status have been then?

(f).

REGULATIONS AS COMPARED WITH STATUTE.

The learned Solicitor has fairly stated (p. 3 and 4, his brief), that the original regulations were changed on January 28, 1921.

A regulation which attempts to decree that a tax does or does not accrue under a certain statute, is not a regulation within the proper meaning of the term, even if it is so labeled by the Department. The proper function of a regulation, adopted pursuant to the statute, is to assist in the enforcement of the law, *not to declare substantive law.* If it is nothing more than an opinion that a certain transactions results in a tax. We must look to the law, and not to the so-called regulation, for the real authority.

We have seen that the trend of this legislation has been toward more liberality for the taxpayer. In striking contrast are the regulations. While Congess has been trying to deal more liberally with taxpayers, the Treasury Department's regulations have had a trend which is the exact converse.

The first regulations was as follows:

"A loss in the sale of an individual's residence is not deductible."

Art. 141, Reg. 45, Prelim. Ed. Feb. 25, 1919.

The same Article, of the same numbered Regulation of Jan. 28, 1921, reads as follows:

> "A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

It is no difficult matter to determine what an individual's residence is. But, on the other hand, it is a most difficult thing to determine what is in a man's mind when he purchases or builds a house. Under the second interpretation, the Treasury Department proposes to determine a man's tax liability by finding out what his intentions were at some distant time in the past—by reading his mind, as it were. If the man is alive and able to testify, he can defend himself. But if he is dead when the case comes to trial, as Senator Knox was, the taxpayer is simply at the mercy of the Treasury Department.

The statute has not changed, but the interpretation has. The simple *ipse dixit* that "a loss in the sale of an individual's residence is not deductible," without qualification or explanation, was found to be unsuitable or inadequate, so another attempt was made *to express the idea of the Department* as to what the statute means. The term "individual's residence" is abandoned, and "residential property," whatever that may mean, was substituted for it, and the taboo was cut down by the addition of "unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

The first change was probably due to the desire to include within their *own* prohibition the case of a man who sold a house which he had *formerly* used as a residence, and which might therefore escape through an unsophisticated inspector or examiner interpreting "an individual's residence" to mean the residence of that individual, and

not a house which he was renting out, or devoting to some other profitable use, but which he had used as a residence twenty years ago. If that was not the purpose sought to be accomplished by that change, we are at a loss to understand the reason for substituting for the simple, easily understood expression "an individual's residence," the uncertain expression "residential property." A block of dwelling houses or an apartment building, may be argued by some people to be "residential property." This would necessitate superimposing an explanation upon an explanation, a new, (third) regulation to clarify the meaning of the previous, (second) regulation, which took the place of the first regulation, which was intended to construe or explain a provision in a statute which needed no explanation.

The cause of the second change, the addition "unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit," is also apparent. The Treasury Department realized how absurd it was to make such a sweeping ruling that "a loss in the sale of an individual's residence is not deductible," without anything more, when the Act plainly says "that losses sustained . . . if incurred in any transaction entered into for profit . . ." shall be deductible. So it created a deductible class by annexing what *it considered* a paraphrase of the language of the statute. And here we have, what generally follows, when an attempt is made to state, in different language, a plain expression,—more confusion. The Treasury Department has created two classes of owners, one, which purchases, or constructs, a house *without* "a view" to subsequently re-selling it "for pecuniary profit," and the other which purchases or constructs *with* such a view. But the party most interested, the home owner, cannot prove what the view was. The Treasury Department says that the presumption is that he belongs to the ~~second~~ first group, and will not permit him "to over-

come (it) by his self serving declaration, uncorroborated, that his purpose was otherwise." (*Sol. L. Op.* 780, 1 C. B. 117.

The above quotation, as to the presumption that applies, and character of proof required to overcome it, is all the more remarkable when we read what precedes it in the opinion:

> "Few, if any, transactions are 'entered into' other than for profit of some kind, but clearly the profit contemplated by the statute is to be pecuniary in character and not simply the pleasure or recreation of the individual, such as his private residence must be to him."

If we understand the musings of the writer of that opinion, it is something like this: *"Few, if any,* persons enter into transactions (and among transactions we will also include purchase of homes) without the expectation or hope of making something, which we admit is a *profit of some kind,* but, before we will allow a man to deduct a loss he has sustained in the sale of his house, we must determine his *object or intent* in buying or building the house. Furthermore, we are to be guided by this general rule in determining the question whether he is to have the deduction, that if he has held the property *out of use* (we presume this means that he has quit using the property as a residence), and uses it as a store or warehouse, or rents it to some one, there *would seem little room for question* that the transaction was entered into for profit, and his loss is to be deducted. In determining his intent, the presumption is the other way,—that he acquired the house without an intent to make profit, (in other words, that he belongs to the *"few, if any,"* class), and that presumption is so powerful that we must not allow him to overcome it by his own declaration or affidavit." (Words in italics are taken from opinion).

Right here we invite attention to the fact that the Treasury Department not only takes the narrow view that "profit" means "pecuniary profit," but narrows the meaning of the words "pecuniary profit" to mean increase in selling price over cost. If a man buys a home, because he thinks that the interest on the investment plus taxes, etc., will still amount to less than the rent he is paying, is not that a transaction entered into for pecuniary profit? And if, in connection with that idea, he also indulges in the hope that he may sell at a profit when he is through with it,—a profit taking into consideration the money he has saved over the rents that he would have paid, there can be no question that the transaction was for pecuniary profit. This Court will take judicial notice of the fact that many people have bought homes, and many others will buy homes, from that motive. Builders, knowing this, advertise, "Buy a home and pay for it out of rents." But the Treasury Department ignores this well known fact, assumes erroneously that the great majority do not have such ideas of thrift, and considers that presumption so strong as not to allow the party concerned to establish it by his own statement. What they would consider corroboration affords a subject for speculation. If he made statements at the time, would they be admissible? And would they divide his motive into major and minor purposes, and what percentage would they assign to each?

It is interesting to observe the conflicting decisions that have been made as a result of the first wrong start the Treasury Department made by its interpretation of the statute:

> "A loss sustained from the sale of property acquired by gift, bequest, devise, or descent (whenever property so acquired is, as a matter of fact, acquired for purposes of profit) is a deductible loss from gross income. Ordinary investment property so acquired is to be treated as having been acquired for purposes of

profit unless the conduct of the recipient furnishes evidences to the contrary."

Advisory Tax Board Rec. 35, 1 C. B. 122.

"A loss sustained upon the sale of residential property acquired by devise was held to be deductible by a taxpayer who soon after acquiring the property placed it with a broker for rent and for sale."

Appeal of Robert Williams, Executor Estate Ellen C. Bonaparte, 1 B. T. A. 1101.

"No deductible loss was sustained by a donee on the sale of a gift in 1919 for less than the cost to the donor and its March 1, 1913 value because the property was not originally acquired by the donee with a view to profit, it having been used as his residence from time of acquisition in 1902 until 1911, when it was rented."

Mandel v. Com., 4 B. T. A. 1001.

and, also,

"A loss upon the sale of taxpayer's residence is not deductible even as to the portion attributable to cost of improvements *made with a view to selling the house* when he continued to reside in it until the sale." (Italics ours).

Appeal of Madden, 2 B. T. A. 702.

In the first above cited, it is held that if a man obtains a house for nothing by gift or devise, and sells it at a "loss," he is entitled to claim a deductible loss, (and no mention is made that this is so only in case he does not use it as a residence), because the Treasury Department decided this should be treated as a transaction entered into for profit. But if he pays for it, he is not entitled to such consideration. It is then not a transaction entered into for profit.

In the second case, the same principle is applied.

In the third case the principle is not applied, and the only difference between it and the second case is something that happened *after* the transaction was entered into; in the former, the owner put it in the hands of a broker to sell, while in the latter he lived in it for a while. But, it will be observed, the use or non-use of the house as a residence was not considered of importance in the first case. When two men find themselves made richer by each being made the devisee of a house, and they both succeed in selling them at about the same time, but one lived in his house, and the other did not live in his, why should the latter be favored over the former so far as receiving a deduction for a loss? It is a piling of Pelion upon Ossa in this structure of error.

(g).

RE-ENACTMENT OF THE STATUTE WITHOUT CHANGE DOES NOT IN THIS INSTANCE INDICATE CONGRESSIONAL KNOWLEDGE OR APPROVAL OF REGULATIONS.

Counsel's argument to the affirmative of this proposition is on pages 7, 14 and 15.

To say that the reenactment of Section 214 (a) (5) of the Revenue Act of 1918, without change, in the Revenue Acts of 1921, 1924 and 1926 indicates that Congress intended to approve and adopt the second interpretation placed upon that section by the Treasury Department is not justifiable.

There is no basis in fact for an assumption that the members of Congress had actual knowledge of these regulations, and were satisfied with them, and, therefore, made no change in the act. We all know that changes in legislation are brought about, principally, in these ways: Either it appears that the effect of a statute, or portion

thereof, is such as to be unsatisfactory to a great number of people, resulting in the creation of a great public sentiment for a change, or some of the leaders in Congress reach the conclusion, for one reason or another, that a change is desirable.

When the time for the enactment of these various revenue laws seemed propitious, the Treasury Department drafted what it conceived should be the form of the new law. In the Treasury Department draft of these several revenue laws no change whatsoever was proposed in so much of Sec. 214 (a) (5) as is before this Court for interpretation. This is shown by Confidential Committee Print No. 1 of H. R. 8245, page 37, July 28, 1921; by Confidential Committee Print No. 1 of H. R. 6715, page 64, December 17, 1923; and by Confidential Committee Print No. 1 of H. R. 1, December 4, 1925. These are the Treasury Department drafts of the Revenue Acts of 1921, 1924 and 1926, respectively. There is nothing in the hearings, the debates in Congress, or the Committee reports on these various bills that would indicate that the interpretation which the Treasury Department had placed upon Sec. 214 (a) (5) of the Revenue Act of 1918 was ever brought to the attention of the Members of Congress, or that they, or any of them, knew what interpretation had been placed upon that section.

Unfair interpretations of a law which affect a relatively small number of people have little chance of being brought to the attention of the leaders in charge of the proposed act. The victims of the improper construction are unorganized. They have felt the force of the ruling and its force has been spent. When it is a question that affects a great number, it forces itself upon the attention of Congress, and the change may be made. But the number of people who have been denied a deduction for a loss sustained upon the sale of a residence is small, and a portion

of that number probably never stopped to consider that the Department's construction of the statute was wrong. They were incapable of having such ideas, because they were not sufficiently informed. It is extremely unlikely that Congress ever heard of these Regulations and rulings made thereunder, for if they had, we would like to have a good reason why they should be satisfied with a provision that allows a deduction for a loss to a man's residence by fire, or other casualty, and a construction of another provision denying a loss through the sale thereof. And if the answer be, that they make a distinction between a loss sustained through a sale, and through a casualty, we ask further, if that be so, why then do they allow a loss sustained in the sale of a residence if the owner received it as a gift, (as they rule in the case of the *Appeal of Robert W. Williams, Executors, supra*), but not if he purchased or built it?

The contention of the learned Solicitor General that reenactment by Congress impliedly validates the Treasury Department's interpretation may well be answered in the words of this court:

> "The government calls attention to the fact that, as early as October 24, 1919, the Commissioner of Internal Revenue made the ruling pursuant to which the tax here in question was assessed; that on March 22, 1920, the Attorney General sustained that ruling; that the provisions here in question were re-enacted without substantial change in the Revenue Act of 1921; and that the administrative practice adopted in 1919 has been steadfastly pursued. It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither *uniform, general,* nor *long continued.* Neither is the statute ambiguous. Such departmental construction cannot be given the force and effect of

law. Compare *U. S. v. Falk*, 204 U. S. 143, *Natl. Lead Co. v. U. S.* 252 U. S. 140."

Iselin v. U. S., U. S. Supreme Court, decided March 1, 1926, 270 U. S. 245 (Brandeis, J.)

(h).

THE BOARD OF TAX APPEALS INTERPRETATION OF THE STATUTE.

The learned Solicitor General has fairly and correctly pointed out (Br. 9, 15) that the Board of Tax Appeals, after nearly a dozen decisions following the interpretation of the Treasury Department, has finally reversed itself and adopted the interpretation which the taxpayer is here contending for.

See:

Appeal of Walter J. Ball, 8 B. T. A. 180.

(i).

THE VALUE AT DATE OF CONVERSION FROM RESIDENTIAL PROPERTY TO BUSINESS PROPERTY IS IMMATERIAL.

Counsel's argument is that the value in 1901, at date of conversion being lacking, it thus becomes impossible to reconcile the Circuit Court of Appeals' decision with *United States v. Flannery*, 268 U. S., 98 and *McCaughn v. Ludington*, 268 U. S., 106, (p. 17 and 18 his brief). Yet on page 13 bottom, he says:

"The Act contains nothing to warrant the determination of gain or loss on the basis of value as of the date when property, acquired and used as a private residence, is leased to others."

That is true,—precisely true. Then why ask this court to be concerned about the value as of the date of leasing? Counsel wants the court to interpret the statute as though

it read "losses sustained only to the extent accrued while a transaction was producing a net revenue." The wording of the statute is not so. It reads "losses sustained * * * if incurred in any transaction entered into for profit." The question is then,—were we engaged in a transaction entered into for profit. We were, and therefore we may take the loss as sustained. The manner and method of computing the loss has been specifically defined by this court in the *Flannery* and *Ludington* cases, *supra,* and it is measured by the difference between the selling price and the cost or March 1, 1913 fair value whichever is lower. It was so computed by the Circuit Court of Appeals and in no income tax case since has a value as of any other different date been considered. Counsel points out (p. 7 and p. 12) the administrative difficulties which would arise if the value at date of conversion had to be resorted to. He is absolutely right,—indescribable confusion would result. Yet he contends that the statute must be so interpreted (p. 18).

It is respectfully submitted that the proper basis for ascertaining the loss is the value of the property on March 1, 1913, since the value on that date is lower than the cost. *The United States v. Flannery, McCaughn v. Ludington, supra.*

(J).

EVEN IF WE ASSUME ARGUENDO THAT THE VALUE AT DATE OF CONVERSION IS A FACTOR.

What the value of the property was in 1901, at date of conversion to rental property, is at best only a moot question here. We know from the findings of fact (p. 21, transcript) that the cost in 1887-8 was $172,000.00, that in 1901 Senator Knox leased the property for $8,000.00 a year, in 1905 he had to reduce the rent to $6,500.00 a year, and in 1915 he had to make a further reduction of rent to $6,000.00. And we know the March 1, 1913 fair value was

$120,000.00. It is unmistakably evident from the decreased rentals that the property was decreasing in value from the time the Senator first rented it in 1901. The only possible way,—accepting counsel's ingenious theory of the case, that the value at date of conversion could become a factor would be that such value was less than the March 1, 1913 value. On the face of the facts that is utterly impossible. To have utilized the value at date of conversion would have resulted in a greater deductible loss for tax purposes than the Senator claimed.

(k).

CONCLUSION.

In conclusion it is respectfully submitted that the judgment of the Circuit Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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March 3, 1928.

SUPREME COURT OF THE UNITED STATES.

No. 341.—October Term, 1927.

D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, Petitioner,
vs.
James R. Tindle and the Union Trust Company of Pittsburgh, Co-executors, etc.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 9, 1928.]

Mr. Justice Stone delivered the opinion of the Court.

Before 1892 the late Philander C. Knox built a dwelling house in Pittsburgh, at a total cost for land and buildings of $172,000. He occupied the house as a residence until 1901 when, circumstances requiring his residence elsewhere, he leased the property at a stipulated rental. He continued so to lease it from October 1st in that year until 1920, when it was sold for $73,000. The fair market value of the property on March 1, 1913 was $120,000. Its value in 1901 does not appear. In his income tax return for 1920 he deducted from gross income the difference between the selling price of the property and its March 1, 1913 value, less depreciation from that date to the date of sale. The commissioner disallowed the deduction and assessed a correspondingly increased tax, which was paid under protest. The present suit was brought in the district court for western Pennsylvania to recover the additional tax assessed. The trial was to the court, a jury having been waived by written stipulation. Judgment was given for the collector, 17 F. (2d) 522, which was reversed by the circuit court of appeals for the third circuit. 18 F. (2d) 452.

The tax was assessed under the Revenue Act of 1918, c. 18, 40 Stat. 1057. Section 214 specifies deductions which may be made from gross income in computing the tax and sub-section (a)5 permits the deduction of "losses sustained during the taxable

year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business." Section 215 provides that "in computing net income no deduction shall in any case be allowed in respect of (a) personal, living, or family expenses." Treasury Regulations 45, promulgated April 17, 1919, and in force during 1920, provide: "Art. 141 . . . A loss in the sale of an individual's residence is not deductible." This was amended on January 28, 1921, to read: " . . . A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit." This regulation has remained unchanged under the Revenue Acts of 1921, 1924 and 1926. See Art. 141 of Regulations 62, Regulations 65 and Regulations 69.

That the exchange value of a dwelling house may increase or diminish is a consideration not usually overlooked by one who purchases it for residential purposes, but the quoted Regulations appear to assume that the acquisition of such property cannot be a transaction for profit within the meaning of sub-section (a)5 of § 214, if the dominating purpose of it is the use of the property for a home. The correctness of that view is not before us, for there is no finding that the taxpayer built his dwelling with any hope or expectation of profit. See *Appeal of D'Oench*, 3 B. T. A. 24.

But the findings amply support the view of the court of appeals that the purpose to use the property as a residence of the taxpayer came to an end when it was leased in 1901, and that from that date until it was sold nineteen years later it was devoted exclusively to the production of a profit in the form of net rentals. It is not questioned that if in 1901 the property had been purchased for that use or inherited and so used the loss might have been deducted, but it is said, as the district court held, that the only transaction entered into with respect to the property was the purchase of the land and the erection of the house, regardless of the use which might afterwards be made of it, and that these acts did not appear to be a transaction entered into for profit.

But the words "any transaction" as used in sub-section (a)5 are not a technical phrase or one of art. They must therefore be taken in their usual sense and so taken, they are, we think, broad enough to embrace at least any action or business operation, such as that with which we are now concerned, by which property previously ac-

quired is devoted exclusively to the production of taxable income. We can perceive no reason why they should not be so taken unless that construction is inconsistent with the purpose or with particular provisions of the Act. Section 214, read as a whole, discloses plainly a general purpose to permit deductions of capital losses wherever the capital investment is used to produce taxable income, and the inclusion of the present deduction in those described in sub-section (a)5 would seem to be entirely harmonious with that purpose.

But it is pointed out that § 202 of the Revenue Act of 1918, prescribing the method of computing gain or loss upon the sale of property, makes value as of March 1, 1913 or cost if acquired later, the basis of the computation. It is said that this is inconsistent with the use of the market value of the property at the date of rental as the basis of the computation, which would be necessary if the construction contended for were given to sub-section (a)5, and that in any case a computation on that basis would involve administrative difficulties in determining the value, which should lead to a different interpretation.

But it is obvious that § 202 is not all inclusive. The same and no greater inconsistency and difficulty arise in the case of property acquired by gift, bequest or devise, when market value at the time of acquisition by the donee and not cost is necessarily the basis of computing the tax. That in such cases the difference between the sale price and market value at the date of acquisition, if after March 1, 1913, is deductible under sub-section (a)5, is not questioned. The ascertainment of market value of the property at that date would not seem to involve any greater administrative difficulty than the ascertainment of market value on March 1, 1913. Section 202 itself provides that in the case of exchange the property shall be taken at this fair market value, and under the Act of 1918 this was likewise provided for in the case of property acquired by gift, devise or bequest, by Regulations 45, Art. 1562, which was incorporated in the later acts. Revenue Act of 1921, c. 136, 42 Stat. 227, § 202 (a)2; Revenue Act of 1924, c. 234, 43 Stat. 253, § 204 (a)2; Revenue Act of 1926, c. 27, 44 Stat. 9, § 204 (a)2.

For the purpose of computing the loss resulting from this particular transaction we think it must stand on the same footing as losses resulting from a similar use of property acquired by gift or devise and that whenever needful the fair value of the property at the time when the transaction for profit was entered into may be taken as the basis for computing the loss.

Article 141 of the Regulations presents no necessary inconsistency with the construction of § 214(a) 5, contended for by the respondent. The article both in its original and in its amended form obviously refers to the sale of residential property of the taxpayer, that is to say, property used by him as a residence up to the time of the sale. Only if that is its meaning can it be reconciled with the Treasury rulings that losses on the sale of residential property acquired by gift, devise or bequest and devoted to rental purposes may be deducted. The loss here has resulted from the sale of property not used for residential purposes by the taxpayer, and the transaction entered into for profit and resulting in the loss was not the purchase of the property but its appropriation to rental purposes. The article of the Regulations by its terms has no application to a loss so incurred.

The findings show that the property was sold for less than its cost and the loss deducted was the difference between its March 1, 1913, value and the sale price. The only loss deductible here under sub-section (a)5 is one incurred in a transaction entered into for profit, later than the date of purchase. For all that appears from the findings the loss which had occurred between the date of purchase and March 1, 1913, may have occurred before the property was devoted to rental purposes. For that reason the findings do not support the judgment. The cause should be remanded for a new trial so that the value of the property as of October 1, 1901, when rented, may be found. If that value is larger than the value of March 1, 1913, the deduction made below should be allowed; if less, only the difference, if any, between its then value and the sale price should be allowed. See *United States* v. *Flannery*, 268 U. S. 98; *McCaughn* v. *Ludington*, 268 U. S. 106.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.